



SOCIAL FINANCING : A SHARIAH COMPLIANT MODEL



Soyan Financial Consultancy
Setting the sharia standards

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EXECUTIVE SUMMARY



Since the last five decades, the world has witnessed a dramatic increase in humanitarian crises as a result of wars, natural disasters, poverty, human right abuses, among others. Based on the Executive Summary of the World Humanitarian Summit (WHS) 2016, in the last two decades, 218 million people each year were affected by disasters at an annual cost to the global economy that now exceeds \$300 billion.

In the 57 OIC member countries, which constitute around 1.6 billion people, humanitarian crises are more severe. Thirty one percent of the total population lives below the poverty line of US\$ 1.25 per day (SESRIC, 2015). Most of the refugee cases and displaced persons are in Muslim majority countries that include Syria, Yemen, Palestine, Somalia and Iraq.

Despite the rise of humanitarian crisis, funds are generally difficult to come by, and even when they are available, they are hardly sufficient to address those current needs. For example, according to the UN estimate, in 2016 there was a US\$15 billion shortfall for funding of humanitarian needs¹. There is therefore a need for restructuring the present system to enhance its efficiency and effectiveness. This need for such restructuring was also discussed at the World Humanitarian Summit (WHS) held in Istanbul in May 2016. The UN Secretary-General report urged support for local and national actors to respond better themselves during crises.

It is against this backdrop that Adeso together with other local and national NGOs came together to form a global network, NEAR (Network for Empowered Aid Response) to reshape the top-down humanitarian and development system to one that is locally driven and owned, and is built around equitable, dignified and accountable partnerships. NEAR with its five sub-groups are concurrently conducting five separate research projects to identify tools and mechanisms to improve access to financial resources for national and local actors to respond effectively and efficiently to humanitarian crises. The present study is headed by one of the sub-group, Soyan Financial Consultancy.

Constructing the proposed ISF model for humanitarian and development system in this study has been an enriching learning experience with few compelling challenges and lessons. One of the challenges is the unavailability of comprehensive data and in-depth research in this area of study. One of the lessons derived in the process of conducting this study is that Islamic social finance occupies a central position in the Islamic social safety nets and poverty eradication programs. ISF is also used as a form of empowerment of the less privileged members of the society. Hence any effective humanitarian and development system model involving local actors in

predominant Muslim societies will have to factor in the ISF schemes. The second important observation is the insufficient national or international funding mechanisms that combines Islamic and non-Islamic funding mechanisms. Such arrangements would be important to help these institutions gain access to external sources of funding at the international level.

The novelty of this study lies in developing an integrated Islamic Social Financing pooled fund model. Since the majority of OIC member countries are poor and lack sufficient funding to respond to humanitarian and development projects, the idea of this model is timely.

The following are the key guiding principles that can be considered for the proposed integrated ISF pooled fund model:

1. Each of the existing models have specific target beneficiaries driven by a clear and transparent humanitarian and/or developmental objective, although the scope can be diverse like in the case of the Life and Livelihood Fund.
2. Central to the effective fund disbursement to target beneficiaries is the role of local actors or intermediaries such as local civil society as strategic implementers or partners in the projects that such funds create. The consideration for partnership should be premised on the capability, reliability and track record of such local actors in implementing the innovative social finance (in particular, Islamic) models in countries that are in need of humanitarian and developmental assistance.
3. While most models are location specific, some have a global focus. It is also noted that the institution that manages the fund does not necessarily need to be based in the locality of the beneficiaries/recipients (for example, the Salma Relief Program in UAE for beneficiaries in Palestinian, zakat and Waqf crowdfunding platforms that will focus on the Western markets).
4. Multiple sources of funding is key to maintaining the “financial sustainability” of the institution as well as “sustainable empowerment” of the beneficiaries. BMT Indonesia is a case in point whereby various types of services are offered to different levels of beneficiaries (for example, the use of takaful, skill training and other non-financial/social assistance). These models focuses on facilitating consumption and productive activities where returns or profits are to be retained for future funding (for example, the Integrated Waqf based Islamic Microfinance Model). Separation of various funding sources would also ensure Shari’ah compliance and minimize potential reputational risk.
5. The sophistication of funding instruments need to be contextualized and paced according to the context of the institution managing the fund and beneficiaries receiving those funds. For example, social impact sukuk, especially a global issuance, is a more complex structure that requires various building blocks to be put in place (for example, credit rating, pricing mechanism, regulatory approval, legal documentation and other structuring process).

6. A robust institutional and governance framework is key to the success of these models. For example, the Zakat Chamber of Sudan has an in-built organizational structure, audit, control and reporting function that would help to maintain transparency and accountability. In some cases, an apex religious body or ministry to ensure compliance with the Shari'ah and with local rules and regulations would be helpful. In the case of social impact sukuk, the presence of evaluation advisers and independent assessors plays an important role in ensuring check and balance.
7. Collaboration with diverse stakeholders helps to expand outreach and impact. The cooperation of BAZNAS of Indonesia with various domestic and international institutions can be a good point of reference.
8. Assessment of impact of the funding would further enhance accountability of the process and increase confidence of donors/investors. The assessment of AIM microfinance program against the principles of Maqasid al Shari'ah is a basic illustration. Other socio-economic impact assessment tools can be adopted in the future, possibly on a real-time basis given the technological improvements nowadays.

The proposed model has seven main structures: 1) the apex body; 2) the board of directors; 3) the entity operating the fund (ISF Fund Cooperation); 4) the risk management and IT system; 5) the source of funds; 6) the Shari'ah compliant investment vehicle; and 7) two departments that allocate the investment proceeds and zakat collection to developmental and humanitarian projects. The funds are disbursed in a way that achieves two main objectives. The first objective is to empower the clients through three investment modes: Islamic microfinance, human resource development and Takaful. The second objective is to respond directly to urgent humanitarian needs of those affected (zakat recipients and disaster victims). The model also diversifies sources of funds to include donations from international donors as well as the potential use of social impact sukuk to invite participation from investors. For the purpose of Shariah compliance and financial sustainability, most of the funds collected will be invested in Shari'ah compliant vehicles.

This report has five parts. Part 1 highlights the humanitarian crises and development challenges predominantly in OIC countries. Part 2 presents Islamic social finance as a global agenda and opportunity, with key conclusions from the special session in the World Humanitarian Summit where government, multilateral organizations, central bank, the private commercial sector and non-governmental organizations join hands to harness the potential of Islamic social finance globally. Part 3 discusses the pillars of Islamic social finance, particularly Zakat, Waqf and Islamic microfinance. Part 4 demonstrates selected prominent ISF models that are relevant to humanitarian and developmental needs. There are six categories of initiatives and practices: Integrated model for humanitarian needs, waqf models, zakat models, Islamic "social" microfinance, crowdfunding platform, and social impact sukuk. Where applicable, the impacts and benefits of these initiatives are highlighted. Part 5 presents the proposed integrated ISF pooled fund model with an aim to establish an ISF fund corporation that can integrate various sources of fund to Shariah compliant investment as well as developmental and humanitarian projects.

It is hoped that the proposed model, once validated, can spur the development of innovative national financing models to meet humanitarian and development needs particularly in OIC countries.

GLOSSARY OF ISLAMIC ECONOMIC AND FINANCE TERMINOLOGY

Zakat	An obligatory contribution or tax which is prescribed by Islam on all Muslims having wealth above an exemption limit at a rate fixed by the Sharī'ah. The objective is to make available to the state a proportion of the wealth of the well-to-do for distribution to the poor and needy.
Waqf	A <i>waqf</i> (plural <i>awqāf</i>) is the product of a voluntary endowment of assets or funds to a trust, whose usufruct is earmarked for purposes specified by the founder.
Wakalah	An agency contract where the customer (principal) appoints an institution as agent (<i>Wakīl</i>) to carry out the business on his behalf. The contract can be for a fee or without a fee.
Takaful	A mutual guarantee in return for the commitment to donate an amount in the form of a specified contribution to the Participants' Risk Fund, whereby a group of participants agree among themselves to support one another jointly for the losses arising from specified risks.
Sadaqah	Voluntary donation.
Qard Hasan	The payment of money to someone who will benefit from it provided that its equivalent is repaid. The repayment of the money is due at any point in time, even if it is deferred.
Muzara'ah	Share-cropping; an agreement between two parties in which one agrees to allow a portion of his land to be used by the other in return for a part of the produce of the land.
Musharakah	A partnership contract in which the partners agree to contribute capital to an enterprise, whether existing or new. Profits generated by that enterprise are shared in accordance with the percentage specified in the <i>mushārah</i> contract, while losses are shared in proportion to each partner's share of capital.
Murabahah	A sale contract whereby the institution sells to a customer a specified asset whereby the selling price is the sum of the cost price and an agreed profit margin. The <i>murābahah</i> contract can be preceded by a promise to purchase from the customer.
Mudarabah	A partnership contract between the capital provider (<i>rabb al-māl</i>) and an entrepreneur (<i>muḍārib</i>) whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless the losses are due to misconduct, negligence or breach of contracted terms.
Ijarah	A contract made to lease the usufruct of a specified asset for an agreed period against a specified rental. It could be preceded by a unilateral

	binding promise from one of the contracting parties. As for the <i>ijārah</i> contract, it is binding on both contracting parties.
Sukuk	Certificates that represent a proportional undivided ownership right in tangible assets, or a pool of tangible assets and other types of assets. These assets could be in a specific project or a specific investment activity that is <i>Sharī'ah</i> -compliant.
Maqasid al-Shari'ah	is the aims or goals intended by Islamic law for the realisation of benefit to mankind. The primary objective of Islamic law is the realization of benefit to mankind, concerning their affairs both in this world and the hereafter

Source: Islamic Financial Services Board; Islamic Research and Training Institute. 2015. "Islamic Social Finance Report."

PART 1: HUMANITARIAN CRISES AND DEVELOPMENT CHALLENGES IN OIC COUNTRIES

Since the last five decades, following the aftermath of the two world wars, the world has witnessed a dramatic increase in humanitarian crises; as a result of wars, natural disasters, poverty, human right abuses, among others. In the last two decades, 218 million people each year were affected by disasters; at an annual cost to the global economy that now exceeds \$300 billion. According to the UNDP, conflict and violence have forcibly displaced 60 million people worldwide, over 38 million of whom are internally displaced, and 19 million refugees. This is the highest number of displaced persons the world has seen since World War II. In 2015 alone, there were a total of 574 reported cases of disasters, caused by earthquakes, floods, landslides and heat waves, killing almost 32,550 people, affecting over 108 million people, and causing US\$ 70.3 billion in damage.² Most of the refugee cases and displaced persons are in Muslim majority countries that include Syria, Yemen, Palestine, Somalia and Iraq. In 2016, there was around 4.8 million refugees in Syria's neighbouring countries and 6.1 million of internally displaced persons according to estimations of UNHCR and UNOCHA (see Figure 1 and 2).

Around one-third of the extreme poor worldwide live in the OIC countries. While extreme poverty has been reduced significantly around the globe in the past twenty years, the reduction is not uniform across OIC countries. In Sub-Saharan Africa, there has been higher poverty reduction in OIC countries than the non-OIC countries in the same region. However, this is not the case in East Asia and South Asia.³ In 21 of the 57 OIC countries, less than half of the population has access to adequate and clean sanitation. Four percent

Views from Global humanitarian Leaders

In the last decade, **humanitarian crises have almost doubled**, with the overall cost of humanitarian assistance increasing by three-fold.

Rapid and unplanned urbanization, population growth, climate change, and conflict continue to pose greater humanitarian challenges, including a **growing strain on resources**.

5 of the **OIC member countries account for over 0.5 billion of the world's poor** with incomes below \$2 a day or national poverty line.

Most OIC member countries rank among the **lowest as per standard development indicators**.

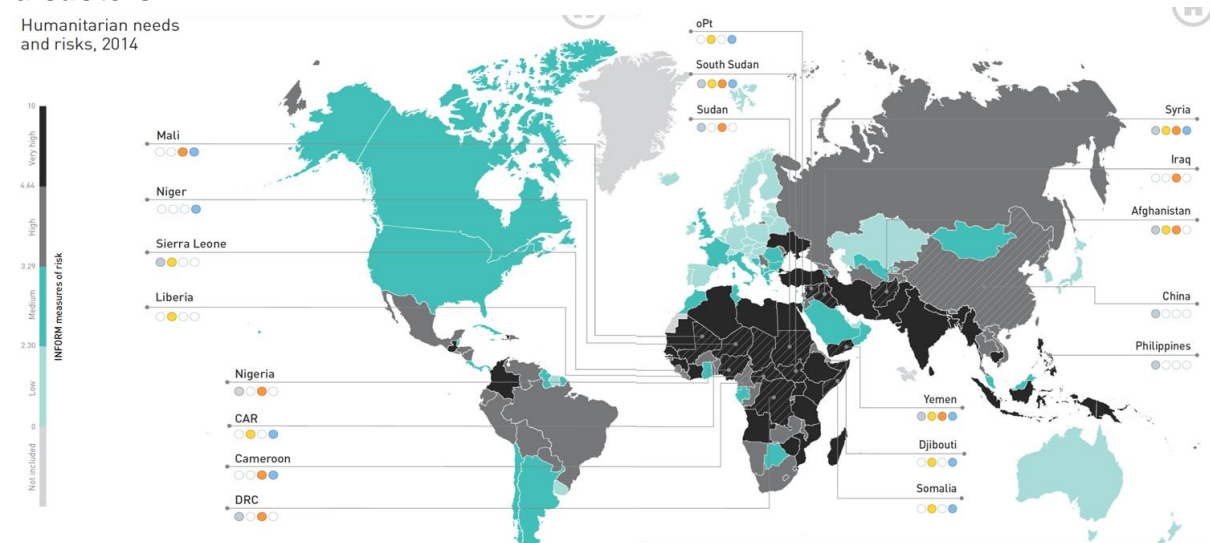
Source: Jemilah Mahmood, "Islamic Social Finance & the Future of Humanitarian Action", 11th WIEF, 4 Nov 2015; Briefing pack of the WHS Roundtable on Islamic Social Finance, Oxford.

² IFRC. 2016. "Resilience: Saving Lives Today, Investing for Tomorrow." World Disasters Report.

³ Islamic Development Bank Group and World Bank Group. 2016. "Islamic Finance: A Catalyst for Shared Prosperity?" Global Report on Islamic finance 2016.

of infants born die before reaching the age of five.⁴

Figure 1: Crises perpetuate in these fragile states. Some are aid dependent for more than 10 years, let alone prepare for future impacts of climate change and disasters.



Adopted from Development Initiatives. 2016. "Global Humanitarian Assistance Report."

Figure 2: Top 10 OIC Member Countries affected by the Humanitarian Crises in 2017

Country	People in Need (Million)	People Targeted (Million)	Requirements (Million/Billion USD)	% Change from 2016
Yemen	18.8	10.3	1.9 B	16%
Syria	13.5	12.8	3.4 B	6%
Iraq	11	5.8	930M	8%
Afghanistan	9.3	5.7	550.2 M	62%
Nigeria	8.5	6.9	1.054 B	118%
Sudan	5.8	4.6	952M	-
Somalia	5	3.9	964 M	-2%
Chad	4.6	2.7	588.8 M	9%
Mali	3.7	1.4	293 M	17%
Cameroon	2.9	1.2	309.6 M	33%

Source: Global Humanitarian Overview 2017, United Nations Office for the Coordination of Humanitarian Affairs OCHA (Data as of January 2017). Note: Preliminary estimates of some countries.

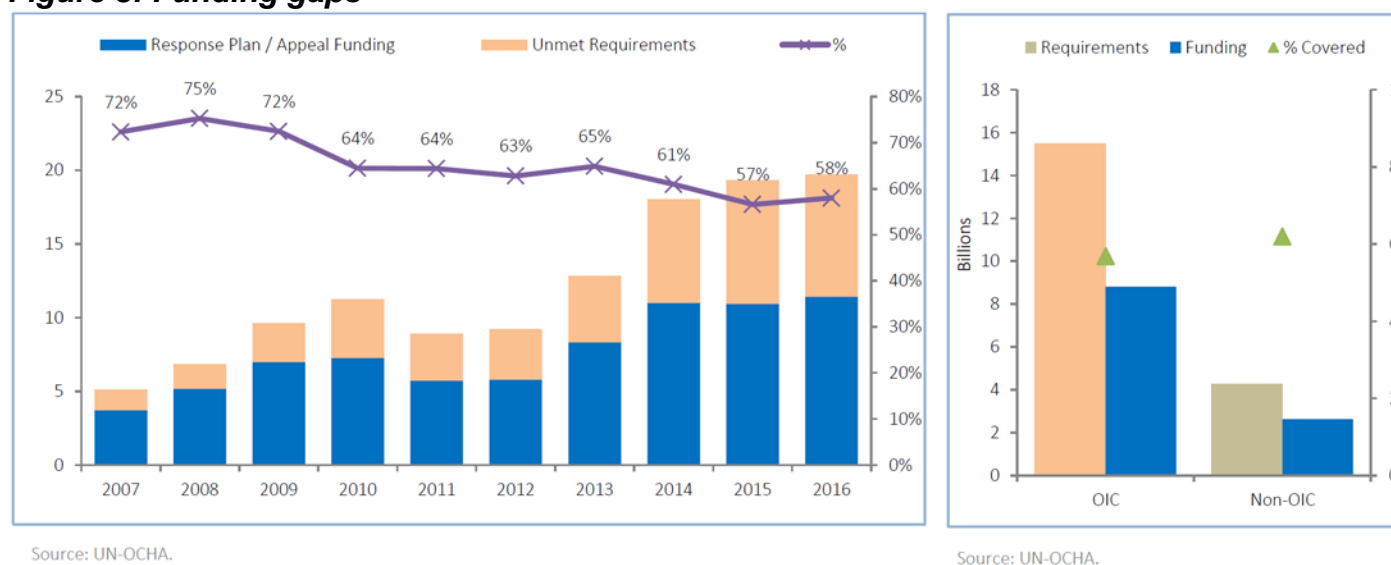
Adopted from SESRIC. 2017. "Humanitarian Crises in OIC Countries: Drivers, Impacts, Current Challenges and Potential Remedies."

With the rise of humanitarian crisis, particularly in OIC member countries, the need for increased funding to respond to these crises also increases. In 2015, more than 95% of the world's conflicts are occurring in OIC countries. Yet the majority of humanitarian funding comes from OECD countries. Yet these funds are generally difficult to come by, and even when they are available, they are hardly sufficient to

⁴ Mohieldin, Mahmoud. 2016. "Could Islamic Finance Help Solve Development Challenges?" World Economic Forum.

address those current needs. For example, according to the UN estimate, in 2016 there was a US\$15 billion shortfall for funding of humanitarian needs⁵ (see Figure 3).

Figure 3: Funding gaps



Adopted from SESRIC. 2017. "Humanitarian Crises in OIC Countries: Drivers, Impacts, Current Challenges and Potential Remedies."

The increasing number of humanitarian crises globally and the shrinking funding for these crises means the existing system of funding may not be sustainable. There is therefore a need for restructuring the system to enhance its efficiency and effectiveness. This need for such restructuring was also discussed at the World Humanitarian Summit (WHS) held in Istanbul in May 2016. The report of the UN Secretary-General for the summit outlined five core responsibilities. In the fifth core responsibility, the UN Secretary-General raises the concern that direct funding to affected national and local non-governmental organizations was very low, only 3 per cent of all humanitarian funding, and it was only just 0.2 per cent of international humanitarian funding in 2014.

In the fifth core responsibility, the need for investing in humanity is proposed, which also includes the responsibility to reduce the funding gap for humanitarian need. The UN Secretary-General report urged support for local and national actors to respond better themselves during crises, without any investment response will remain without returns. The World Humanitarian Summit Global Consultation's summary report, also endorsed the creation of a SNGO managed pooled fund to increase direct finance to local actors. In 2015, the Islamic Development Bank Group (IDBG) adopted its 10-Year Strategy (10-YS) to be implemented during the period 2016–2025, with the aims to promote inclusive and sustainable socioeconomic development and enhance cooperation between IDB member-countries.

It is against this backdrop that Adeso together with other local and national NGOs came together to form a global network which was launched in May 2016 at the World Humanitarian Summit in Istanbul, Turkey. The network, NEAR (Network for

⁵ OCHA. 2016. "Global Humanitarian Overview 2016."

Empowered Aid Response), is a movement of local organizations with a bold ambition – to reshape the top-down humanitarian and development system to one that is locally driven and owned, and is built around equitable, dignified and accountable partnerships. NEAR with its five sub-groups are concurrently conducting five separate research projects to identify tools and mechanisms to improve access to financial resources for national and local actors to respond effectively and efficiently to humanitarian crises. These research projects aim at contributing towards ensuring greater efficiency and accountability of humanitarian funds as humanitarian needs continue to grow.

The present study is headed by one of the sub-group, Soyan Financial Consultancy. The study explores the best practices among institutions in the Islamic Social Financing (ISF) for the purpose of building models that can cater for financing humanitarian crises.

PART 2: ISLAMIC SOCIAL FINANCE (ISF) AS A GLOBAL AGENDA AND OPPORTUNITY

While the global Islamic finance industry's assets are worth USD2 trillion and are forecasted to rise to USD5 trillion by 2020, Islamic social finance is an under-explored territory according to the High-Level Panel on Humanitarian Financing Report to the UN Secretary General, "Too important to fail—addressing the humanitarian financing gap".⁶ The Islamic Development Bank (IDB)'s research on zakat (mandatory alms-giving) in 2015 conservatively estimates between US\$ 232 billion and US\$ 560 billion circulating annually.⁷ With just one per cent of zakat, there could be enormous contribution to the scale of the global funding deficit for the year 2015. While there is no specialized coordination mechanism or an autonomous body to help channel ISF funds effectively at the global or regional level for humanitarian action, there is potential for ISF to fill the humanitarian funding gap if organized mechanisms to collect and distribute these funds could be established at national levels given the large scale of contribution from Muslim societies globally.

Figure 4: Islamic social finance can potentially fill the humanitarian funding gap⁸

US\$ 200 billion to US\$1 trillion are spent annually in zakat and sadaqah across the Muslim world, several times more than the conventional global humanitarian aid contributions (just over US\$13 billion in 2011).

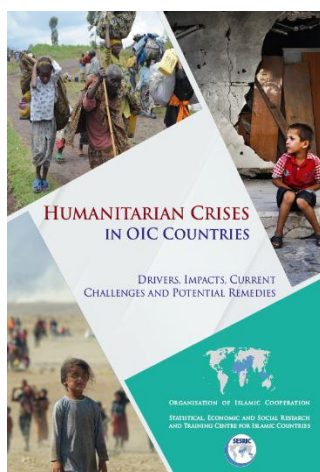
A minimum of US\$600 billion of excess zakat from 40 OIC countries is potentially distributable annually for humanitarian action.

However, contribution from the Muslim world to the humanitarian system in recent years is only 5-7%. Muslim countries' contribution to the Central Emergency Response Fund of the United Nations has been below 0.05% since 2006. This could be because Muslims cannot give their zakat to non-Islamic institutions as there are strict requirements on how the funds can be used and how they must be managed. Only 1% of the annual excess Islamic social funds were sufficient to plug the humanitarian gap in 2014.

⁶ United Nations. 2015. "High-Level Panel on Humanitarian Financing Report to the Secretary-General: Too Important to Fail—addressing the Humanitarian Financing Gap."

⁷ Shirazi, Nasim Shah. 2014. "Integrating Zakat and Waqf into the Poverty Reduction Strategy of the IDB Member Countries." *Islamic Economic Studies* 22 (1): 79–108. Shirazi, Nasim Shah, and Muhammad Anas Zarka. 2017. "Social Tax and Transfers for Poverty Alleviation: A Case for Low- and Middle- Income Countries." In *Handbook of Empirical Research on Islam and Economic Life*, 253–72. Edward Elgar Publishing.

⁸ Mahmood, Jemilah. 2015. "Islamic Social Finance & the Future of Humanitarian Action." In 11th World Islamic Economic Forum. Kuala Lumpur. Islamic Research and Training Institute. 2014. "Islamic Social Finance Report." Islamic Research and Training Institute. 2015. "Islamic Social Finance Report."



The OIC's Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC) report on "Humanitarian Crises in OIC Countries: Drivers, Impacts, Current Challenges and Potential Remedies" in February 2017 notes that embarking on own potential to solve own problems could be highly effective in reducing vulnerabilities and building resilience in OIC countries. The report recognizes that the ISF, blended with other corporate finance instrument, can be an effective financing mechanism that serves the basic needs of the vulnerable people as well as support them to be economically self-reliant.

A humanitarian action plan has been formulated in the SESRIC report to mobilize innovative financing mechanisms for humanitarian and development assistance:

THE IDENTIFIED RESILIENCE THEMES & RESPONSIBILITY		STRATEGIC ACTION PLANS			
		DO NEW	DO MORE	DO LESS	DO STOP
MOBILIZE INNOVATIVE FINANCING MECHANISMS FOR HUMANITARIAN ASSISTANCE AND DEVELOPMENT	Govt. Ministries related to Religious Affairs, Central Bank, Commercial / Investment Banks, Development Aid, Private Sector, Civil Society as well as donors network	Issuing innovative Humanitarian Sukuk or other instrument, which is different from type structure of corporate funding exercise, so that it places greater emphasis on impact and efficiency in resource mobilization, monitoring and evaluation.	Mainstreaming the mobilization of ISF Components (i.e. <i>Waqf</i> , <i>Zakat</i> and <i>Sadaqah</i>) via crowdfunding platform, for which become the alternative source for <i>ad hoc</i> and cross-border humanitarian assistance intervention and resilience development initiative, with greater involvement from private sector for more sustainable development	Reducing unstructured and uncoordinated resource mobilization of the Islamic Social Finance to the same beneficiary, as well as duplication of resources from other actors.	Propagating mistrust amongst the Muslims about the potential of Islamic Social Finance for cross-border humanitarian intervention, due to lack of understanding on <i>Maslahah</i> needs and the robustness of funds' governance.

Adopted from SESRIC. 2017. "Humanitarian Crises in OIC Countries: Drivers, Impacts, Current Challenges and Potential Remedies."

These strategic action plans dovetail with the key conclusions reached from the special session on ISF during the World Humanitarian Summit in May 2016 where government, multilateral organizations, central bank, the private commercial sector and non-governmental organizations join hands to harness the potential of ISF globally.



Key conclusions:



- The **Islamic Development Bank** and the **World Bank** agreed in principle on the potential of Islamic Social Finance instruments to make an important contribution to aid funding;
- The **Organization for Islamic Cooperation** (OIC) committed to collaborate with the IDB and Statistical, Economic, Social Research and Training Centre for Islamic Countries (SESRIC) to further examine how ISF could assist in filling in the humanitarian funding gap in consultation with the OIC Member States;
- **Luxembourg** has been active in Islamic Finance for over four decades and committed to extend its support to unleash its potential for humanitarian action;
- **Maybank Islamic** and **Norwegian Refugee Council** announced a global humanitarian waqf (endowment fund) to support displaced people, protracted, underfunded and forgotten emergencies;
- The **Central Bank of Indonesia** launched an international standards setting body for ISF instruments with principles developed in collaboration with IDB, with the goal to improve use and governance of zakat (almsgiving) and waqf (endowment fund) for humanitarian action;
- The **United Nations Development Programme** (UNDP) and **IDB** co-established the Global Islamic Finance and Impact Investing Platform.

In the case of zakat, the formation of the International Working Group on Zakat Core Principles (ZCP) in 2014-2015 is expected to strengthen the cooperation and governance quality of zakat institutions globally. The ZCP document was launched on 23-24 May 2016 in Istanbul, Turkey and at present two derivatives technical notes documents have been published namely, Technical Notes on Risk Management for Zakat Institution and the Technical Notes on Good Amil Governance.

PART 3: THE PILLARS OF ISLAMIC SOCIAL FINANCE

The world's major religions have elements of almsgiving, which are also used for responding to humanitarian crises at varying degrees. The exact figure of religiously motivated giving is hard to trace. There is evidence that Islamic countries and those with large Muslim populations continue to play significant roles in humanitarian assistances. From 2011 and 2013, international humanitarian assistance from governments within the Organization of Islamic Cooperation (OIC) grew from US\$599 million to over US\$2.2 billion, representing a growth of 4%-14% in the share of total international humanitarian assistance from governments. The figures could be much higher as much of these funds for humanitarian assistance by OIC governments and faith based groups go unreported.

Islamic Social Finance (ISF) comprises the traditional Islamic institutions based on philanthropy and mutual cooperation as well as the more contemporary institution of not-for-profit and for-profit Islamic microfinance. These ISF institutions have formally and informally played significant roles throughout Islamic history. The formal institutions are those with defined organizational structures that mobilize funds from the public and distribute them to the target recipients. Meanwhile those informal ones are normally run by individuals in the communities who are trusted to administer the funds. The main objectives of ISF is the alleviation of hardship, poverty and human suffering through mobilization and channelization of financial and material resources to the destitute and needy. The concept of ISF is rooted in the fundamentals of the Islamic faith and forms an integral part of the Islamic social fabric that promotes risk sharing, compassion, brotherhood and duty to other human beings.⁹

The present research focuses on the formal institutions, particularly Zakat, Waqf, Islamic microfinance and sukuk. These three are widely used across Muslim countries to address societal needs at local, national and international levels.

Zakat

Literally, Zakat means to grow, to increase and to purify. Technically, it refers to the determined share of wealth prescribed by God to be distributed among deserving categories. It is also used to mean the action of payment of this share.¹⁰ Zakat is one of the five pillars of Islam and thus a compulsory levy on the excess wealth of an adult and sane Muslim individual if the wealth remains in the ownership of the individual for one Hijri calendar year (hawl) and has exceeded the minimum threshold (nisāb). Zakat is a multi-dimensional measure in the sense that the sources of Zakatable wealth vary across the major sectors of the economy and the same time, the recipients are derived from the different sections of needy members of the society.

The sources of Zakatable wealth are: Livestock, Gold and Silver, Business inventory (products available for sale), Agriculture, Honey and Animal Products, Minerals and Sea Products, Capital Goods, and Earning of Laborers and Professionals. The conditions for one Hijri calendar year (hawl), the minimum threshold (nisāb) and

⁹ Islamic Research and Training Institute. 2015a. "Islamic Finance Primer." Islamic Research and Training Institute. 2014. "Islamic Social Finance Report."

¹⁰ Qardawi, Yusuf Al. 2013. *Fiqh Al Zakah*. Islamic Book Trust.

Zakat rate vary within these categories. For example, Zakat on agriculture does not conform to the condition of hawl as it is levied immediately upon harvest at a rate of 10% if watered naturally or 5% if watered artificially. Meanwhile Zakat rate for business inventory is 2.5% of the net asset value in the current year.

In terms of the recipients, "Islam imposes restrictions on the use of Zakat funds and require that funds must clearly flow only to specific categories of beneficiaries".¹¹ The Quran (9:60) specifies the following eight categories of Zakat recipients: Al-Fuqarā (the poor), Al-Masākīn (The needy or the destitute), Al-ʿāmilīna ʿAlayha (Zakat administrators), Al-Muʿallafate-Qulūbuhum (those whose hearts are reconciled; that is, those who have embraced or are inclined towards Islam), Fi al-Riqāb (People in bondage or slavery), *Al-Ghārimīn*: (People burdened with debt), Fī-sabīllillāh (those in the path of God), and Ibn al-Sabīl (The wayfarer, or stranded traveller). Most of these eight recipients are directly or indirectly linked to humanitarian or development assistance.

The state of al-Fuqara is a result of both a humanitarian or developmental crisis that is directly experienced by the majority of the world population. The difference lies in the causes of poverty. It could be economical, social, political or as a result of a natural disaster or conflict. Therefore, a large proportion of al-Fuqara are in need of humanitarian assistance, especially those living in abject poverty. As of April 2013, half of the 7.1 billion world population live in abject poverty.¹² The al-Masākīn or the needy are the second category besides the poor. This category can apply to anyone in need of assistance in the aftermath of a crisis or disaster. Further, it can also apply to other vulnerable groups in dire needs.

High level of indebtedness can lead to poverty for al-Ghārimīn and thus a humanitarian or a development recipient. Zakat can be used as one of the effective mechanisms to relief al-Ghārimīn from the burden of debt. Meanwhile Fi al-Riqāb category applies to those who are enslaved, oppressed or wrongly imprisoned, or to victims of trafficking. Ibn al-Sabīl or the wayfarer is a stranded traveller who could be a refugee or internally displaced person. Zakat can be paid in a variety of ways to such persons through different institutions, both governmental and non-governmental.

There is no reliable data currently available to show precisely how much Zakat is being paid by Muslims around the world, or how it is spent globally. Estimates show that a minimum of US\$600 billion of excess zakat from 40 OIC countries is potentially distributable annually for humanitarian action. In fact, data collected for Indonesia, Malaysia, Qatar, Saudi Arabia and Yemen, which make up 17% of the world's estimated Muslim population, indicates that in these countries alone at least US\$5.7 billion is currently collected in Zakat each year.¹³ If we also consider Zakat currently being paid through informal mechanisms, then the actual amount available is likely to be much higher, and could potentially be in the hundreds of billions of

¹¹ Islamic Research and Training Institute. 2015a. "Islamic Finance Primer." Islamic Research and Training Institute. 2014. "Islamic Social Finance Report."

¹² Population Reference Bureau. 2013. "2013 World Population Data Sheet."

¹³ Stirk, Chloe. 2015. "An Act of Faith: Humanitarian Financing and Zakat." Global Humanitarian Assistance. IRIN. 2012. "A Faith-Based Aid Revolution in the Muslim World?" Islamic Research and Training Institute. 2014. "Islamic Social Finance Report."

dollars. By way of comparison, international humanitarian assistance from government and private donors in 2016, reached to US\$28.0 billion¹⁴. The research shows that between 23% and 57% of Zakat currently being collected is used for humanitarian assistance, depending on the context in which it is raised and used. It is therefore likely that Zakat is already a significant source of humanitarian financing in many places, and there are indications that it has the potential to provide considerably more humanitarian assistance than is currently the case.

According to the Global Islamic Finance Report 2016, zakat potential under Z1 varies from about 1.00 percent of GDP to 1.74 percent of GDP in the five predominantly Muslim countries (Figure 5). Under Z2, potential zakat ranges from 2.00 percent of GDP to 3.71 percent of GDP, while under Z3 it ranges from 2.25 to 4.18 percent of GDP. While the resource shortfall in Bangladesh is much higher than its potential zakat collection, countries like India, Nigeria, South Africa, and Sudan can easily generate resources for poverty alleviation. In Kenya, for example, the resource gap for extreme poverty is 0.32 percent of GDP, while corresponding potential zakat collection is 0.30 percent of GDP, using the Z3 measure. This is, however, not the case for Tanzania which would be unable to bridge the resource gap with potential zakat collection. The Global Islamic Finance Report 2016 suggests that the potential resources from zakat collection alone can meet the shortfall in resources required for poverty alleviation in most countries in the sample.

¹⁴ Development Initiatives. 2016. "Global Humanitarian Assistance Report."

Figure 5: Estimates of the potential of Zakat and gap in resources needed to alleviate poverty

Percentage of GDP

Country	Z1	Z2	Z3
Bangladesh	1.63	3.48	3.92
India	0.26	0.55	0.63
Indonesia	1.59	3.39	3.82
Malaysia	1.11	2.36	2.66
Pakistan	1.74	3.71	4.18
Kenya	0.13	0.27	0.30
Nigeria	0.86	1.84	2.08
South Africa	0.03	0.06	0.07
Sudan	1.44	3.08	3.47
Tanzania	0.54	1.15	1.30

Country	Resource gap at \$1.25 a day (percentage of GDP)	Resource gap at \$2.00 a day (percentage of GDP)
Bangladesh	7.570	33.360
India, total population	2.390	12.590
India, Muslim population	0.344	1.813
Indonesia	0.350	2.740
Malaysia	None	0.020
Pakistan	1.620	13.350
Kenya	0.320	0.960
Nigeria	1.470	3.500
South Africa	0.001	0.010
Sudan	0.490	2.200
Tanzania	3.020	8.170

Sources: Global Islamic Finance Development Center calculations, based on Obaidullah and others 2014; Obaidullah and Shirazi 2015.

Adopted from Islamic Development Bank Group and World Bank Group. 2016. "Islamic Finance: A Catalyst for Shared Prosperity?" Global Report on Islamic finance 2016. Sources: Global Islamic Finance Development center calculations, based on IRTI's Islamic Social Finance Report 2014 and 2015.

Note: Z1 is estimated in accordance with the majority traditional view. Z2 is based on the view of some contemporary Muslim scholars that zakat is payable on net returns of manufacturing concerns, rentals of buildings, and net savings out of salaries. Z3 is based on views of the Maliki school.

Waqf

Waqf is generally defined as “a type of Islamic endowment that can take the form of cash, property or any form of private wealth which is donated in perpetuity for a charitable purpose set and directed by the endower”.¹⁵ Traditionally Waqf has taken the form of real estate, particularly in the Middle East where in the 19th century up to two thirds of all property in the Ottoman Empire was held as Waqf assets. Most Waqf is real estate assets that have been donated by an individual for the sole purpose of providing charity to a particular institution and that institution uses the returns from that assets in sustaining its activities. However, more recently cash Waqf has become more popular where donors are providing cash Waqf for a particular institution, a school, a mosque, hospital or NGO, to invest in a commercial project and the returns on that investment is used for charitable and, where applicable, reinvestment purposes. One of the important aspects of Waqf relates to its objective, which is doing charity in exchange of reward from the Creator. The objective of Waqf may be for the society at large, including the provision of religious services, socio-economic relief to the needy segment, the poor, education, and environmental, scientific, and other purposes.

The Waqf industry is undeniably growing in importance as global Muslim wealth increases. In many Middle East countries, such as Qatar, Kuwait and Saudi Arabia, Waqf structures are widely available and a favoured method of charitable giving; while the sector is also once more growing in popularity in countries such as Lebanon, Egypt and especially Turkey; which has seen an explosion in charitable funding since the revision of its waqf regulations in 1981, with wealthy families competing to make endowments particularly in the education sector. The global size of Waqf assets is estimated between US\$105 billion to US\$1 trillion.¹⁶ In Indonesia, the market value of registered land Waqf is estimated to be US\$ 60 billion. In Malaysia there is 11,091 hectares of land under Waqf valued at of US\$ 384 million.¹⁷

It has been shown that Waqf projects in Islamic countries are used as strategy for developing economic sector and alleviating poverty. Traditionally, Waqf had been used for providing clean water, building orphan houses and bridges, organizing funerals and financing the marriages. However, this trend has been changed with the advent of the industrial revolution. Currently, Waqf assets are financing education, health and social welfare to promote social development. In Malaysia, the Waqf funds are being used for establishment of cooperative housing, industrial companies, libraries, laboratories and research centres.

The history of Awqaf is very rich with prominent achievements in serving the poor in particular and addressing soci-economic development challenges. Various kinds of Awqaf were established during the Ottoman Empire including those for public utilities, education, research, and health care. Hospitals and medical services are one of the most famous sub-sectors of Waqf. Muslims continued to establish Awqaf hospitals and health care centers until the first part of the 20th century when the

¹⁵ Ahmed, Habib. 2007. “Waqf-Based Microfinance: Realizing the Social Role of Islamic Finance.” World Bank.

¹⁶ Singh, Ranjit Ajit. 2014. “Welcome Address.” In 5th SC-OCIS Roundtable on Islamic Finance: Harnessing Waqf into a Bankable Social Financing and Investment Asset Class. Kuala Lumpur.

¹⁷ Islamic Research and Training Institute. 2014. “Islamic Social Finance Report.”

Waqf Children Hospital of Istanbul was founded.¹⁸ Similarly, there were Waqf of grain to be used as seeds, and forms of Waqf to provide loans to persons who need financing and providing charity to ultra-poor families.

Islamic Microfinance

The Consultative Group to Assist Poor of World Bank defines “microfinance” as ‘the provision of formal financial services to poor and low-income (and, for credit, in particular, non-salaried) people, as well as others systematically excluded from the financial system.’ Over the last two decades, microfinance is proven to be an effective development tool for poverty alleviation in many countries across the globe. Microfinance industry is rapidly expanding worldwide with the target to eradicate poverty. Although it is argued that Microfinance institutions have not been reaching the poorest of the poor yet, their programs have brought numerous benefits to the poor.

There is increasing recognition of the potential of Islamic financing principles in the operation of micro finance institutions. Islamic Microfinance institutions are receiving greater attention and becoming more popular as it can overcome most of the existing challenges of conventional MFIs. These include: asymmetric information problems, economic viability caused by high operating and administrative cost for monitoring loan operations, and dependency on foreign aid. In addition, conventional MFIs face additional challenges such as charging fixed interest rates, limited products, high dropout rate and non-graduation from poverty, debt trap and over-indebtedness due to compounded high interest rate. Their lack of Shari’ah compliance and cultural values (as it deals with interest/riba) and lack of human capital investment tools exacerbate the problems.

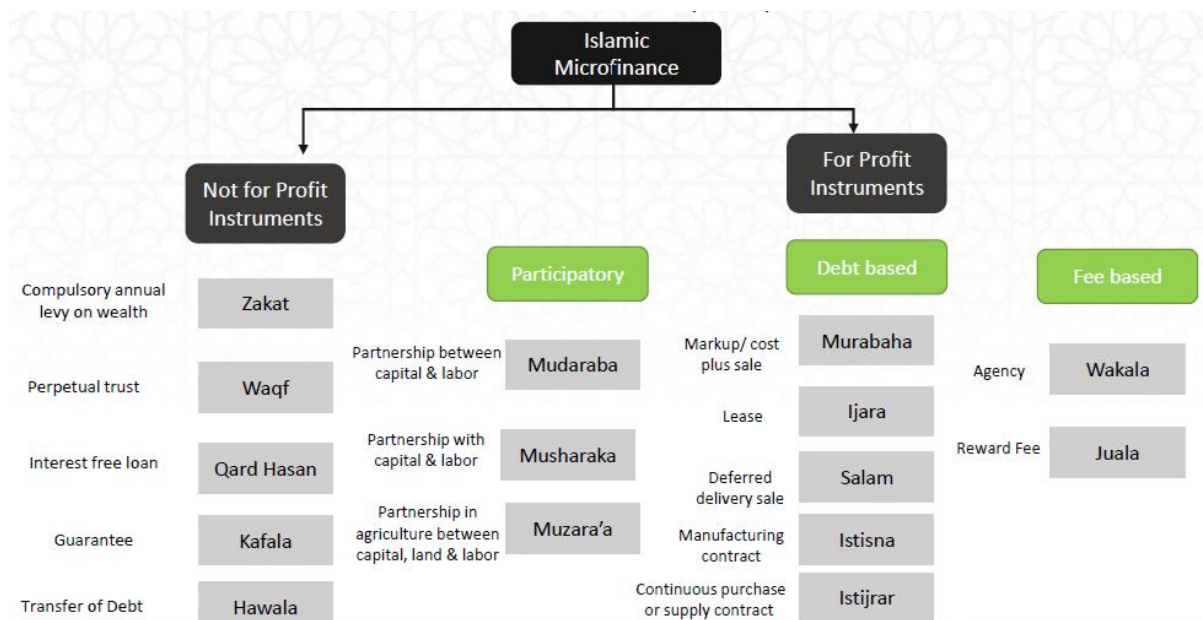
In principle, Islamic microfinance does not have an inbuilt business incentive to promote indebtedness and exorbitant interest rates. Imposing high interest rate on the poor segment of the society resulted in over-indebtedness and social problems. According to India’s National Crime Records Bureau, more than 87,000 farmers committed suicide between 2002 and 2006 because of huge debts borrowed from microfinance institutions.¹⁹ Empirical research at INCEIF suggests that Islamic microfinance institutions are free from mission drift issues due to their unique business model and commitment to Shariah regulation.²⁰

Figure 6: The main instruments of Islamic microfinance

¹⁸ Ahmed, Habib. 2007. “Waqf-Based Microfinance: Realizing the Social Role of Islamic Finance.” World Bank.

¹⁹ Europe Economics. 2015. “Interest Free Microfinance and Impact on Poverty Alleviation.”

²⁰ Mobin, Mohammad Ashraful. 2017. “On the Determinants of Mission Drift and Outreach-Financial Performance Trade-Offs of Microfinance Institutions.” Unpublished PhD thesis, INCEIF.



Adopted from Islamic Research and Training Institute. 2015a. "Islamic Finance Primer."

Sukuk

Sukuk in the context of money and capital markets refer to certificates or securities (bonds), representing financial rights arising from underlying trade and other commercial activities. It evidences an undivided ownership right or interest, wholly or partially, in a Shari'ah-compliant tangible asset, intangible asset, usufruct, commodity, or business as a going concern, or a participation right in any Shari'ah-compliant profit-sharing venture, or a Shari'ah-compliant financial asset, or any combination thereof through a mixed portfolio of various assets.²¹

In recent years, social impact sukuk has been gaining traction as the new frontier for the Islamic finance industry. In a recent article exploring the potential of social impact sukuk, Michael Bennett and Akinchan Jain the World Bank suggest that a social impact sukuk appeals to investors from both the Islamic and conventional ethical finance sectors as it combines "true risk sharing and a focus on a specific social cause with a fully Shari'ah compliant sukuk structure". Social impact sukuk enhances multi-stakeholder collaboration by aligning incentives among stakeholders and focusing on result-oriented objectives. Social impact sukuk can offer an additional avenue of mobilizing sustainable funding for social projects and enhance the effectiveness of current funding. The use of private capital reduces fiscal pressure especially in countries where taxation is low and government funds are limited. The focus on paying for results rather than paying for activities allows the government to reallocate resources efficiently to where it is most needed and helps to reduce the need for international borrowing and overseas aid. By anticipating and addressing social issues before they arise, social impact

²¹ International Shari'ah Research Academy for Islamic Finance (ISRA) and Securities Commission Malaysia. 2015. Islamic Capital Markets: Principles and Practices.

sukuk facilitates the shifting of resources from remediation to less costly preventive solutions.²²

²² Bennett, Michael, and Akinchan Jain. 2014. "Social Impact Sukuk: A New Frontier for Islamic Finance." Islamic Finance News, November.

PART 4: MODELS AND IMPACTS OF ISLAMIC SOCIAL FINANCE

Part 4 presents and discusses selected prominent ISF models that are relevant to humanitarian and developmental needs. There are six categories of initiatives and practices: Integrated model for humanitarian needs, waqf models, zakat models, Islamic “social” microfinance, crowdfunding platform, and social impact sukuk. Where applicable, the impacts and benefits of these initiatives are highlighted.

Integrated model for humanitarian and developmental needs

Life and Livelihoods Fund (LLF)

The Lives and Livelihoods Fund was launched in September 2016. Its funding members include: the Gates Foundation, the Islamic Solidarity Fund for Development (a poverty reduction arm of the Islamic Development Bank Group (IDB)), the King Salman Centre (each donating up to \$100 million), the Qatar Fund for Development and the Abu Dhabi Fund for Development (each donating \$50 million). Over the five years (2016-2020), the pooled Fund will be making US\$ 2.5 billion available for projects to assist the poorest people in the IDB member countries in order to lead better and more productive lives.

The LLF scales up through additional grants to enhance concessional financing on terms that are significantly more affordable than market-based financing. Administered by the IDB, low- and lower middle- income countries can borrow funds to finance agricultural (20-60 percent), health (20-60 percent), and infrastructure (maximum 20 percent) projects. Several countries have been identified to be eligible for such financing (Figure 7(a)).

Figure 7(a): Eligible countries financed through the LLF

Eligible countries* financed through the Lives and Livelihoods Fund

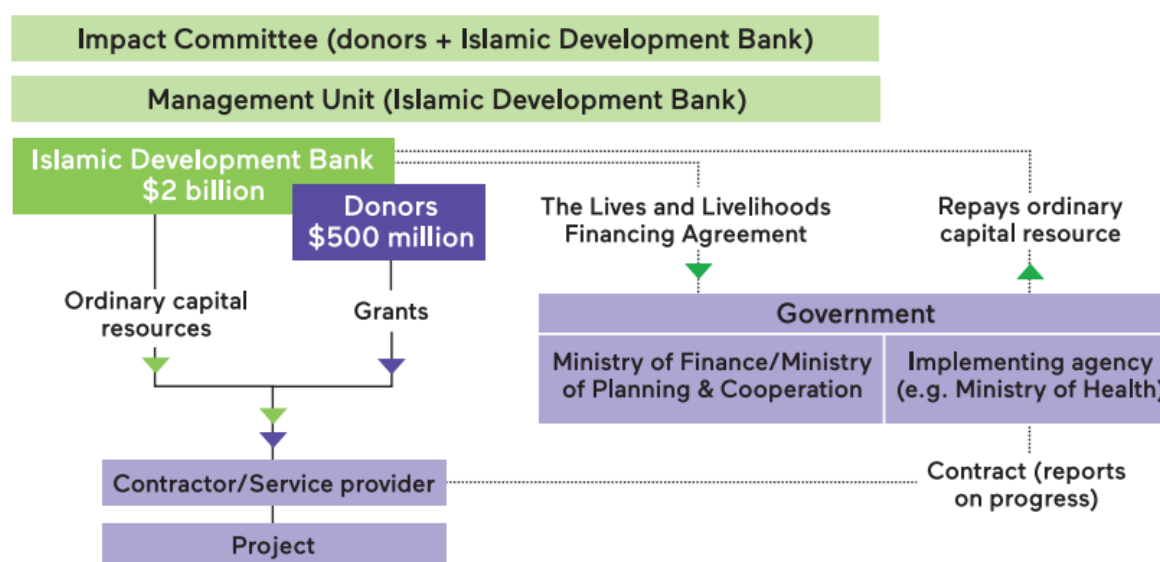
Afghanistan	Guinea	Pakistan
Bangladesh	Guinea Bissau	Palestine
Benin	Indonesia	Senegal
Burkina Faso	Kyrgyz Republic	Sierra Leone
Cameroon	Maldives	Somalia
Chad	Mali	Sudan
Comoros	Mauritania	Tajikistan
Côte d'Ivoire	Morocco	Togo
Djibouti	Mozambique	Uganda
Egypt	Niger	Uzbekistan
The Gambia	Nigeria	Yemen

* 95% of the Lives and Livelihoods Fund resources will target the least developed member countries (shown above in purple) and the lower middle-income member countries (shown above in green). IsDB shall not allocate more than 20% of the Project Financing Funds to any single country.

Adopted from “A Guide to the Lives and Livelihoods Fund: A unique global partnership for financing projects to build a better future in Islamic Development Bank member countries.”

The IDB supports the governing committee of donors and the day-to-day operations of the LLF (Figure 7(b)). 1 percent of its resources is allocated to the Project Preparation Facility to ensure that the projects being financed are of the highest quality. Once projects enter the project pipeline, the Project Preparation Facility helps member countries shape and design them for submission to the Impact Committee and approval by the Board of the IDB. This support may involve, for example, commissioning technical, feasibility or impact studies, conducting baseline surveys or community consultations, or building capacity in project management. Once financing agreements have been signed, the IDB established an in-country Project Management Unit (PMU) to launch the project and monitor progress.

Figure 7(b): Life and Livelihood Fund model



Adopted from “A Guide to the Lives and Livelihoods Fund: A unique global partnership for financing projects to build a better future in Islamic Development Bank member countries.”

Salma Relief Program

Innovative mechanisms to bear and share the risks of crisis-hit victims such as the Salma relief program by the United Arab Emirates are one such example that could contribute to improving humanitarian assistance. Salma was established as a waqf with an international focus to deliver halal-certified food to crisis-hit victims based on transparent and trackable supply chains. Automatic digital tracking system via a unique number is linked to each donation to address donors’ concerns about loss, theft, and the usage of their donations. The supply chain and the Salma-branded food pouches are certified fit for global distribution by the United Nations World Food Program. The food is based on bespoke recipes designed to enhance acceptance by crisis-hit victims and to help alleviate their malnutrition. The people of Gaza were the first beneficiary of Salma’s food relief program in 2014. Salma, named after the first Emirati woman nurse who served for more than 50 years to save people’s lives in the United Arab Emirates, was the 2014’s winner in the food and health category of the Islamic Economy Award.

Through the contribution of al-Adha sacrificial meat and other donations, the Salma initiative mobilizes profits from the treatment of secondary products from cattle and livestock (such as wools, leather, and fat) into an endowment to cover costs and for the potential development of both financial and nonfinancial products to provide food aid permanently. The initiative has the beauty of combining (voluntary and mandatory) charitable contributions, entrepreneurship, endowment, finance, and humanitarian relief, of which all are manifestations of *ihsan* (goodness) in a risk-sharing paradigm.²³

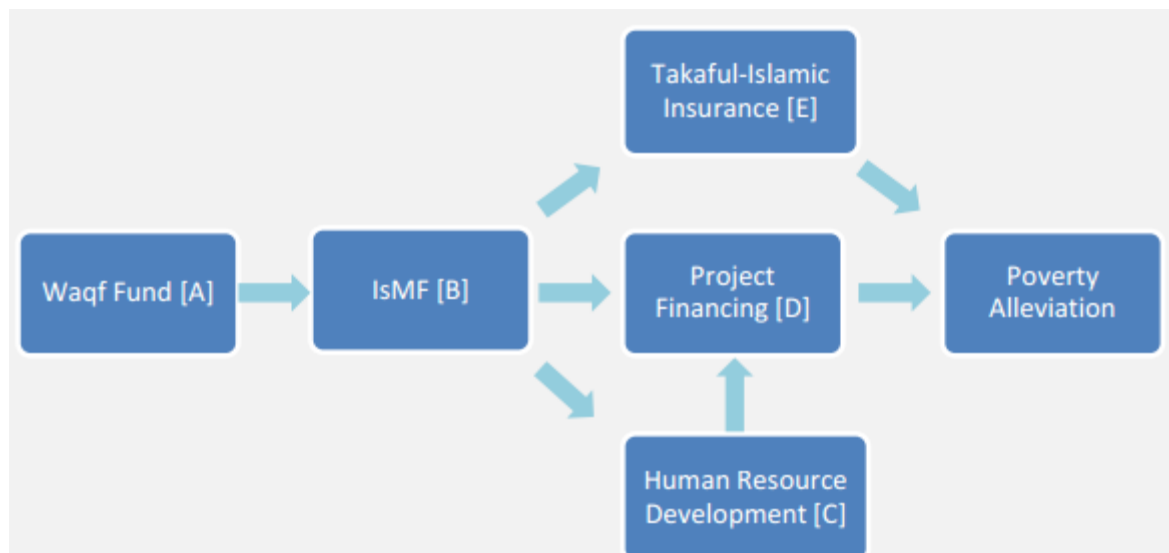
Integrated Waqf based Islamic Microfinance Model for Poverty Alleviation

An Integrated Waqf based Islamic Microfinance Model (IWIMM) for poverty alleviation in OIC member countries has been developed by the Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC) and International Islamic University Malaysia in 2015.²⁴ IWIMM comprises five components: Waqf fund [A], Islamic Microfinance [B], Takaful [E], Project Financing [D] and Human Resource Development [C]. Waqf is sourced to provide subsidized funding for Islamic microfinance to empower the poor through skill development, business projects and Takaful or Islamic Insurance. The Waqf fund used in the IWIMM model is expected to finance productive activities where the returns or profits will be retained for future funding. This would enable perpetuity of Waqf fund for other potential activities in future.

Figure 8: The Proposed IWIMM

²³ Adopted with permission from Ng, Adam, Abbas Mirakhor, and Mansor H. Ibrahim. 2015. "Risk Sharing and Social Impact Partnerships." In *Social Capital and Risk Sharing: An Islamic Finance Paradigm*. New York: Palgrave Macmillan.

²⁴ Alpay, Savaş, and Mohamed Aslam Haneef. 2015. "Integration of Waqf and Islamic Microfinance for Poverty Reduction: Case Studies of Malaysia, Indonesia and Bangladesh." The Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC) and International Islamic University Malaysia. Haneef, Mohamed Aslam, Aliyu Dahiru Muhammad, Ataul Huq Pramanik, and Mustafa Omar Mohammed. 2014. "Integrated Waqf Based Islamic Microfinance Model (IWIMM) for Poverty Alleviation in OIC Member Countries." *Middle-East Journal of Scientific Research* 19 (2): 286–98.



Adopted from Alpay, Savaş, and Mohamed Aslam Haneef. 2015. "Integration of Waqf and Islamic Microfinance for Poverty Reduction: Case Studies of Malaysia, Indonesia and Bangladesh." 5 The Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC) and International Islamic University Malaysia.

Illustration of Figure 8:

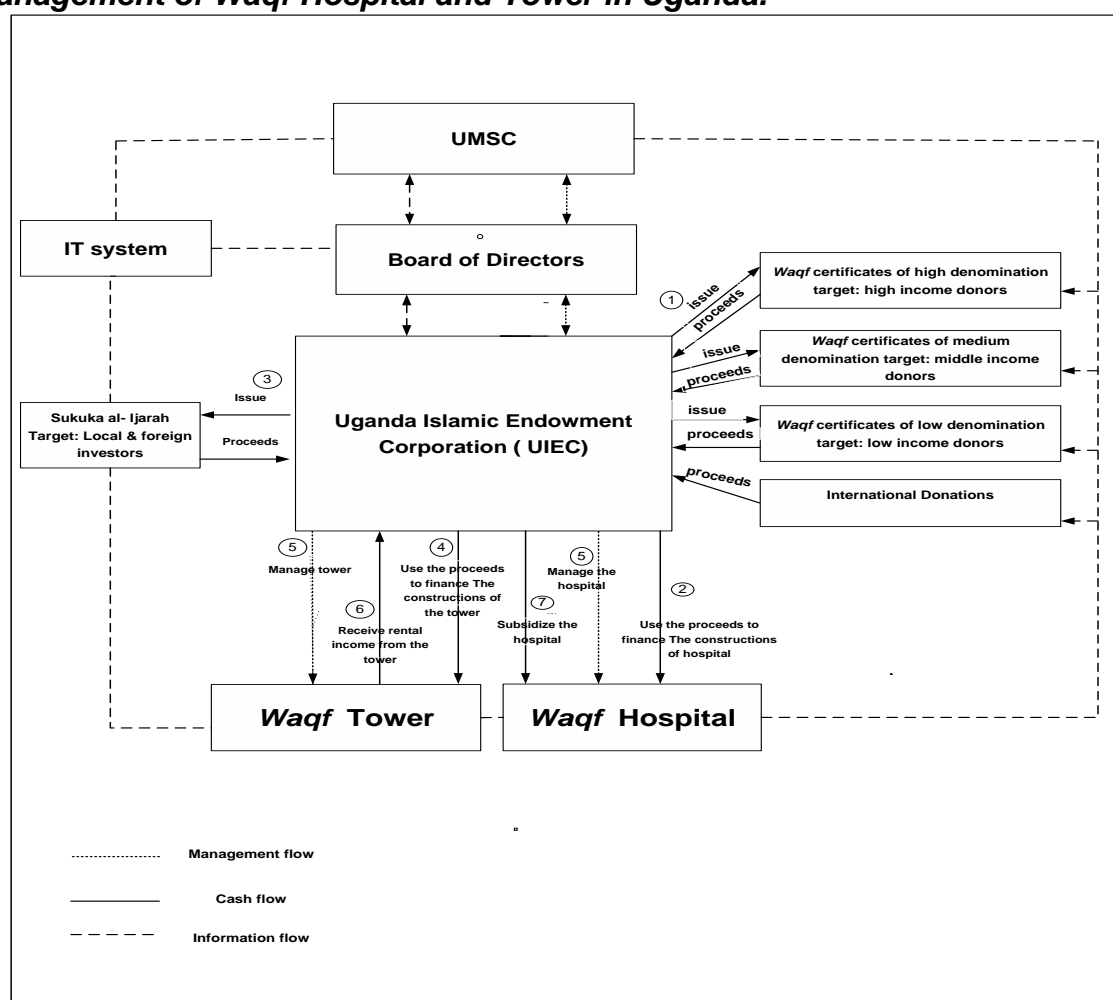
- [A] Waqf funds can be used to reduce the cost of capital for expanding Islamic microfinance activities;
- [B] Islamic microfinance (IsMF) can offer Takaful coverage, project financing and human resource development programs;
- [C] Human resource capacities acquired can subsequently complement proper project implementation;
- [D] Successful implementation of funded projects is expected to contribute towards poverty alleviation;
- [E] Takaful coverage is expected to mitigate the financing and family risks of the poor.

The proposed IWIMM was validated through field survey in Malaysia, Indonesia and Bangladesh. Generally, Islamic microfinance contributes positively to takaful financing, human resources development, and takaful financing contributes positively to poverty reduction across the three countries. Interviews and focus group studies suggest that financial flow must be in parallel with real transaction in terms of skill development, training on product development, marketing, motivation and infrastructure for poverty alleviation. Project financing can be in the form of small/medium/large projects financed by Waqf/Zakat/charity funds and can follow the principles of venture capital. The proposed model can be implemented by Islamic microfinance institutions together with other Islamic NGOs. Additional funding may be generated from charity, donation and public funds for social assistance in addition to waqf.

Waqf-based Model for Financing a Construction and Management of Waqf Hospital and Tower in Uganda

Dr. Umar Ahmed developed a model for financing the construction of a modern Waqf based hospital in Uganda. In the model, funds will be solicited through Waqf certificates, international donation and Sukuk. Similar to the view of AbulHasan Sadeq,²⁵ the funds solicited in this model are used for financing two projects: the primary and the secondary. The primary project is the hospital itself while the secondary project is a building tower that is financed through the Waqf certificates, hence the Waqf Tower. This building tower will be leased to the public and the revenue generated will be used to cover the regular operational cost of the hospital.²⁶

Figure 9: Proposed Waqf-based Model for Financing a Construction and Management of Waqf Hospital and Tower in Uganda.



Adopted from Ahmed, Umar. 2003. "Developing a Waqf Based Model for Modern Health Care Services in Uganda." Unpublished PhD thesis.

Zakat models

BAZNAS (Indonesia)

²⁵ Sadeq, AbulHasan M. 2002. "Waqf, Perpetual Charity and Poverty Alleviation." *International Journal of Social Economics* 29 (1/2): 135–51.

²⁶ Ahmed, Umar. 2003. "Developing a Waqf Based Model for Modern Health Care Services in Uganda." Unpublished PhD thesis.

The development of zakat in Indonesia has increased significantly upon the replacement of Zakat Act No. 38/1999 with the Zakat Act No. 23/2011. The contribution of zakat and charitable spending (infaq and sadaqah) has grown substantially in Indonesia since 2012. Zakat constitutes the largest portion of collection in the case of individual contributors while sadaqah has the largest share in the case of institutional contributors (Figure 10(a) and (b)).

Figure 10(a): The growth of Zakat, infaq and sadaqah collection (individual) in Indonesia (Adopted from the Indonesia Zakat Outlook 2017)

Year	2012	2013	2014	2015	2016*
Zakat	20,779,335,226	23,320,146,044	117,085,731,136	234,207,296,949	284,775,967,586
Infaq	1,407,465,859	1,635,310,122	23,499,642,443	35,677,250,486	81,729,424,572
Sadaqah					
TOTAL	22,186,801,085	24,955,456,166	140,585,373,579	269,884,547,435	366,505,392,158

Source: Primary Data of BAZNAS (2016); *taken from SIMBA BAZNAS until August 2016

Figure 10(b): The growth of Zakat, infaq and sadaqah collection (institution) in Indonesia (Adopted from the Indonesia Zakat Outlook 2017)

Year	2012	2013	2014	2015	2016*
Zakat	16,771,638,926	19,091,201,735	35,916,501,176	61,987,632,803	72,354,281,978
Infaq	13,495,855,415	4,126,077,822	9,382,342,129	12,101,996,858	20,312,579,146
Sadaqah					
TOTAL	30,267,494,341	23,217,279,557	45,298,843,305	74,089,629,661	92,666,861,124

Source: Primary Data of BAZNAS (2016); *taken from SIMBA BAZNAS until August 2016

The latest Act brought all major private collectors under the supervision of National Board of Zakat (BAZNAS).²⁷ Under this Act, instead of only charity based mechanism, the disbursement of zakat can also be done using productive mechanism. Thus zakat recipients are required to utilize the fund for productive purposes that will enable them to be self reliant.

Its major milestone includes the launching of the National Zakat Index in 2016, certification of ISO 9001: 2000 in 2008 and “The Best Innovation Program” and “The Best in Transparency Management” at IMZ Award 2011.

BAZNAS cooperates with various ministries and state institutions in the country as well as the IDB, UNDP and World Zakat Forum (representing zakat institutions from 20 countries). In April 2017, UNDP Indonesia signed agreements with BAZNAS, Bank Jambi, and Bank NTT. A proposal is underway to develop a clean water facility in Nusa Tenggara using the Islamic charitable fund zakat that is collected and managed by BAZNAS. UNDP also signed a cost-sharing agreement with Bank Jambi to develop renewable energy in the form of micro hydro power plant in villages that do not have access to electricity.²⁸

²⁷ BAZNAS is a non-structural government institution that is independent and responsible to the President through the Minister of Religious Affairs. BAZNAS ensures the management of zakat is based on the principles of Shari'ah compliance, amanah (accountability and trust), benefit, justice, legal certainty, and integrity.

²⁸ UNDP. 2017. “UNDP Collaborates with BAZNAS and Financial Institutions to Achieve the Sustainable Development Goals (SDGs).”

According to the Indonesia Zakat Outlook 2017, the following areas are expected to be conducted by BAZNAS:

- a) institutional consolidation that includes the adjustment to recent regulations, assigning BAZNAS leaders at the provincial and district level, and the alignment to the national zakat vision and mission by all national zakat campaigners;
- b) strengthening the strategy of collection and distribution of zakat nationwide in order to reduce the gap between the potential of zakat and the actual collection. Systematic public education and cooperation with other authorities such as OJK and Bank Indonesia should be enhanced. One key attempt is the implementation of zakat obligation in the Islamic stock market and financial institutions;
- c) coordination with Bank Indonesia and the Ministry of Finance on the establishment of an Inclusive Islamic Financial Services Board to improve the quality of zakat management globally.

Zakat Chamber (Sudan)

Since the passing of Shari'ah laws in the 1983, the Sudanese zakat chamber has evolved through different stages: Zakat Fund in 1980, Zakat and Tax Chamber in 1984 with a legislation requiring zakat to be levied by the force of law. In 1988 the Chamber became an independent Zakat Chamber. The organizational structure of Sudanese zakat chamber comprises the supreme council of trustee, the General Secretary, the fatwa committee, the administrative and executive body and the grass-root zakat committees. It has mechanisms in place to ensure disclosure and transparency of activities (for example, strict system of auditing). The fatwa committee ensures that all the Chamber's operations are in compliance with Shari'ah code of ethics. The internal and external auditors have full access to the records of the Chamber, and they send their reports directly to the supreme council of trustee. The financial report is discussed by the supreme council of trustee and the states council as well as the government legislative bodies.

The Chamber has made many partnerships in different sectors. One good example is the partnership with the ministry of agriculture to irrigate wide areas for the benefit of poor. The Chamber shares resources with the ministry of finance to give support to the needy people through social funding programmes. It also provides humanitarian support to refugees and people escaping from war.

The Chamber obtains money from person who are eligible zakat payers, at a rate of 2.5% of the payer's eligible wealth. The Chamber is of the view that there is no need for mechanisms to mitigate reputational and other financial risks, since they make the decision to distribute all the proceeds and seldom have excess money. The Chamber is of the view that there could be an option to have a pool fund.

Islamic "social" microfinance

There are several successful Islamic microfinance institutions (MFIs). These include Amanah Ikhtiar Malaysia (AIM) launched in 1987. In Indonesia, there are three

different popular Islamic microfinance institutions: (i) the Islamic Rural Bank known in Indonesia as Bank Pembiayaan Rakyat Syariah (ii) Koperasi Baytul Maal wat Tamwil (BMT) providing savings and credit cooperative services based on profit and loss sharing principles; and (iii) Grameen-model Islamic microfinance. These Islamic Microfinance institutions also provide micro Takaful via an agent called Takaful Mikro Indonesia. In Pakistan, the prominent microfinance institutions are the Akhuwat, Asasah, Wasil Foundation, previously known as Centre for Women Cooperative Development (CWCD), Islamic Relief Pakistan (IRP), Muslim Aid, Helping Hand, Namet, Khwendo kor, the Farz Foundation, Karakoram Cooperative Bank (KCBL), and the National Rural Support Program. In Sudan, the Central bank of Sudan established a microfinance unit in 2007. Later the Central Bank of Sudan issued a circular in 2008 where all banks must reserve at least 12% of their total loan portfolio for microfinance clients. Other countries known for Islamic microfinance are Bangladesh and Egypt.

According to the study by the United Nations Development Programme (UNDP) in 2012 on Bangladesh, Islamic microfinance was relatively more successful in reducing poverty than conventional microfinance. Mohammed Obaidullah of the Islamic Development Bank conducted a comparative study on the performance of conventional and Islamic MFIs in Bangladesh with regards to poverty alleviation.²⁹ He found that RDS (Rural Development Scheme) of Islami Bank Bangladesh Ltd (IBBL) was better in terms of growth (12.5%), dropout rate (5%), and operational efficiency as compared to three conventional leaders in microfinance: Grameen Bank, ASA (Association for Social Advancement), and BRAC (Bangladesh Rural Advancement Committee). He argues that Islamic MFIs charge lower rate of return (10% with 2.5% rebate for on time payment) than other microfinance (16% to 22.5% of interest). Furthermore, his findings suggest that Islamic MFIs in Bangladesh provide active spiritual development program with the purpose to improve members' awareness of social right and responsibility in order to improve better relationship with others. Similarly, based on field survey of 1,024 clients of Islamic MFIs, Mizanur Rahman and Fariduddin Ahmad observed a 33% increase in the family income, 50% increase in health expenditure, increase of family employment from 1.91 to 2.1 working members, and overall increase in all types of assets.³⁰

Islamic MFIs also have some social impacts, such as improvement of religious knowledge, brotherhood, healthcare capacity building. A comparative study of Islamic and conventional microfinance in Bosnia found that Islamic MFIs are contributing significantly toward the social development of the society³¹. Mizanur Rahman and Fariduddin Ahmad found an increase of health awareness, brotherhood and social capital among the clients of Islamic MFIs in Bangladesh. Another research examined the impacts of four Islamic MFIs on clients and employees in Pakistan. Shariah compliant microfinance was found to contribute to well-being, per capita income, educational level, ethical values and employment level in the society.

²⁹ Obaidullah, Mohammed. 2008. "Role of Microfinance in Poverty Alleviation: Lessons from Experiences in Selected IDB Member Countries." Islamic Development Bank.

³⁰ Rahman, M. Mizanur, and Fariduddin Ahmad. 2010. "Impact of Microfinance of IBBL on the Rural Poor's Livelihood in Bangladesh: An Empirical Study." *International Journal of Islamic and Middle Eastern Finance and Management* 3 (2): 168–90.

³¹ Hamad, Mohammad, and Teoman Duman. 2014. "A Comparison of Interest-Free and Interest-Based Microfinance in Bosnia and Herzegovina." *Evropejskij Iissledovatel* 79: 1333–50.

Moreover, the clients and employees are equally satisfied with Islamic MFIs due to religious perspective and prohibition of riba.³²

BMT: The Indonesian model of Islamic “social” microfinance

BMT³³ Social Ventures Limited is a not-for-profit organization to eradicate poverty in Indonesia by boosting rural community development through venture philanthropy. It was established independently by the people following Islamic microfinance mechanism with a mission of “Supporting the poor to help themselves”. It is now known as a social enterprise with a legal form of cooperative in developing productive community.

With branches/offices of 780 units and 11,380 employees, BMT connected members/beneficiaries of 2,174,342 persons and has impacted the lives of 8,697,368, from a network of 3,000 BMTs (members of Perhimpunan BMT Indonesia). BMT is a smart and proactive “bridge” between government, donors, investors and banks, companies – suppliers, buyers and CSR, universities, research centers, media, etc. for a sustainable world and enriching lives. The approach of BMT include (1) saving; (2) customized products and services through many BMTs; and (3) A blend of social and business to support micro-entrepreneurs. BMT is actually developing productive community alongside helping in education, disaster recovery, healthcare, infrastructure and other social activities.³⁴

BMTs offer three types of services to the poor, micro financing, social welfare funds (zakat), and entrepreneurship trainings.³⁵ It has two major divisions: Maal (social) division and Tamwil (commercial). The Tamwil division focuses on providing commercial financing for micro, small and medium- sized enterprises (MSMEs) which are profit generating activities. The source of commercial funding comes from members (savings in the form of safekeeping (wadiah)), Islamic banks (loans/financing), and investors. The Maal division focuses on social activities such as providing grants and non-commercial financing (qard-al-hasan) for the poor to commence their own business. These activities are funded by zakat, infaq, sadaqah, wakf from various sources.³⁶

Figure 11: BMT Flow of funds and progression to prosperity

³² Aslam, Muhammad Naveed. 2014. “Role of Islamic Microfinance in Poverty Alleviation in Pakistan: An Empirical Approach.” *International Journal of Academic Research in Accounting, Finance and Management Sciences* 4 (4): 143–52.

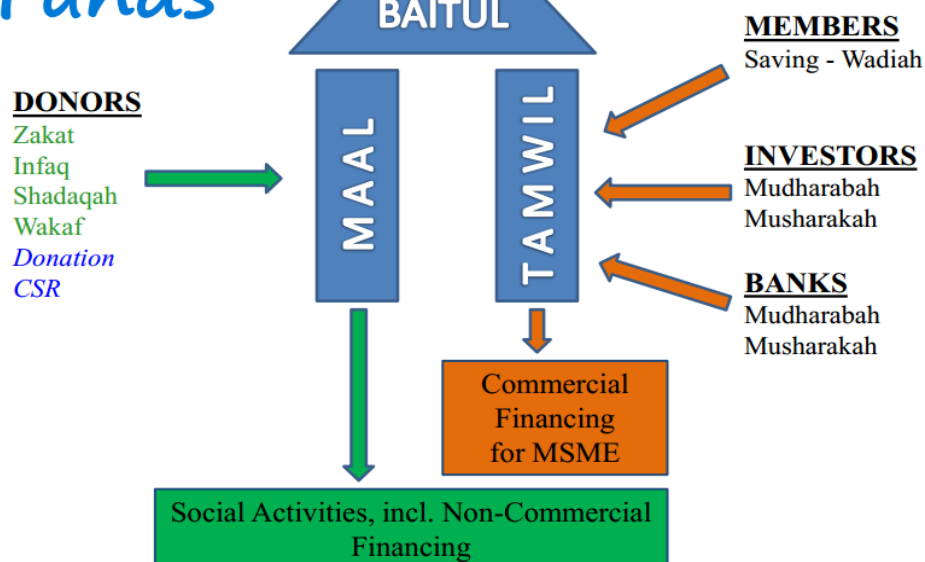
³³ BMT = Baitul (House) Tamwil (Business) Maal (Social) or Baitul Maal wat Tamwil (The House of Social and Business)

³⁴ Abbas, Jamil. 2014. “BMT: The Indonesian Model of Islamic Microfinance, and the Importance of A Union in Supporting the Growth of Islamic Microfinance Institutions in the Country.” In *11th Kuala Lumpur Islamic Finance Forum 2014*. Kuala Lumpur.

³⁵ United Nation Development Program. 2012. “Poverty Reduction: Scaling up Local Innovations for Transformational Change.”

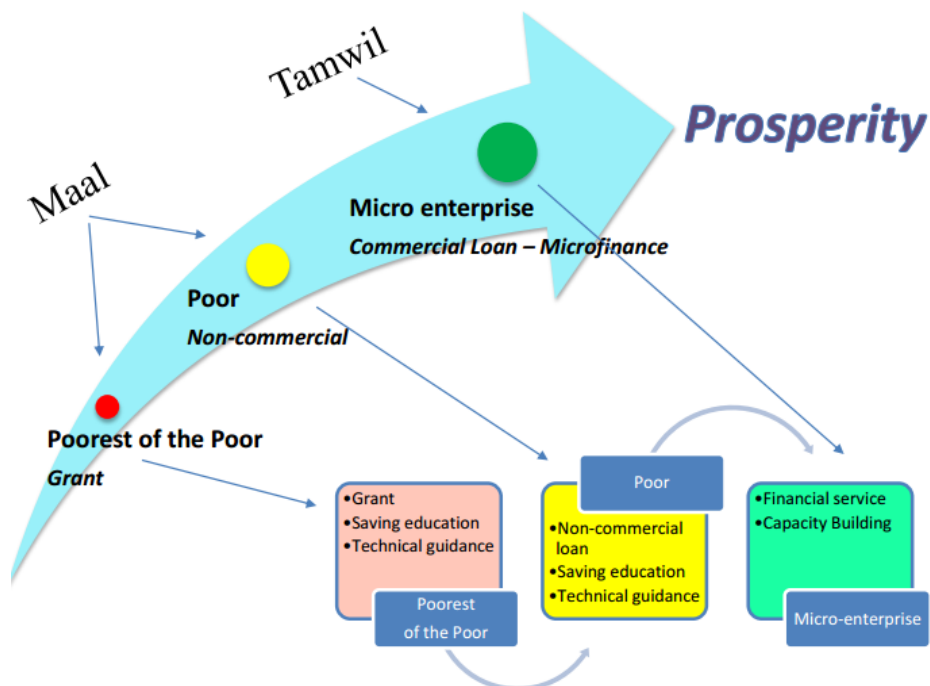
³⁶ Islamic Business and Finance. 2015. “BMT: Indonesia’s Unique and Effective Model for Islamic Microfinance.”

Flow of Funds



Adopted from Abbas, Jamil. 2014. "BMT: The Indonesian Model of Islamic Microfinance, and the Importance of A Union in Supporting the Growth of Islamic Microfinance Institutions in the Country." In 11th Kuala Lumpur Islamic Finance Forum 2014. Kuala Lumpur.

While typical microfinance can only provide commercial loans, which can only be used by people who have income generating capacities, BMT alleviates the poorest of the poor through the Maal division via various tools such as grant, saving education, technical guidance. Commercial financing comes at a later stage of progression (through non-commercial loan, other financial services and capacity building).



Adopted from Abbas, Jamil. 2014. "BMT: The Indonesian Model of Islamic Microfinance, and the Importance of A Union in Supporting the Growth of Islamic Microfinance Institutions in the Country." In 11th Kuala Lumpur Islamic Finance Forum 2014. Kuala Lumpur.

Islamic microcredit programs of Amanah Ikhtiar Malaysia (AIM)

According to Islamic belief, Shariah has a higher objective (Maqasid) that aims to promote the betterment (Masalih) of mankind under a divine (one god: Allah) guideline. These objectives are the protection and promotion of religion, life, intellectual, lineage/honor and wealth. In this regard, one recent study examined the role of Islamic microcredit programs based on the achievement of Maqasid Al-Shariah, using primary data that were collected through a questionnaire survey based on 393 microcredit borrowers from Amanah Ikhtiar Malaysia (AIM)³⁷ between July 2013 and December 2013.³⁸ The results reveal that Islamic microcredit program of AIM has a positive and significant effect on the livelihood of clients. This effect is demonstrated in the assessment of their prosperity, especially in the setting of Maqasid Al-Shari'ah (the higher objectives of Shari'ah).

According to the study, among the five principles, the indicators of Ad-Din (religion), Al-Nafs (life), Al-Nasb (lineage/honour) and Al-Mal (wealth) improved after participating in the microcredit program, as per more than 80 per cent of the borrowers. However, the indicators of Al-Aql (intellect) were not significantly enhanced by this program in comparison with the other principles. Many borrowers claimed that their participation in the microcredit program did not assist them in gaining additional knowledge or business skills. Borrowers with long periods of involvement with the AIM microfinance program reported higher volumes of income than those with a short period of attachment. However, this increase in income remains inadequate to fulfil the basic needs of these respondents. The AIM microfinance program had a low significant effect on the savings and asset ownerships of the borrowers. While the savings volume of the borrowers increased on a monthly basis, 43.8 per cent of these borrowers had no savings even after joining AIM. Nonetheless, a small improvement was observed in the asset ownership of the borrowers (i.e. land, jewellery, and vehicle). Among the respondents, 35 per cent owned land, 20 per cent owned jewellery and 55 per cent owned vehicles. With regard to the employment (occupation) pattern, the respondents were moderately able to participate in income-generating activities. Most of the respondents diversified their source of income by working more than one job to increase income.

Figure 12: Achievement of the microcredit program based on Maqasid al-Shariah

³⁷ AIM is considered a successful microcredit organization. It is the largest Grameen Bank replication outside Bangladesh. Given its performance, AIM received the Best Islamic Microfinance Institution award during the 2013 and 2014 Global Islamic Finance Awards.

³⁸ Alam, Md. Mahmudul, Salwana Hassan, and Jamaliah Said. 2015. "Performance of Islamic Microcredit in Perspective of Maqasid Al-Shari'ah." *Humanomics* 31 (4): 374–84.

Principles	Role measurement variables	Scale ^a (data in %)				
		1	2	3	4	5
Religion (<i>Ad-Din</i>)	Changes in religious practices		10	10	50	30
	Life (<i>Al-Nafs</i>)				100	
Intellect (<i>Al-Aql</i>)	Changes in health status		10		90	
	Changes in social participation				70	30
	Changes in social contribution				100	
	Changes in level of knowledge			30	70	
	Changes in business skills and experience			40	40	20
Lineage/honor (<i>Al-Nasb</i>)	Changes in the level of knowledge of the family				70	30
	Changes in lineage/honor among the family members				60	40
Wealth (<i>Al-Mal</i>)	Changes in perception of society			20	80	
	Changes in monthly household income				100	
	Changes in ownership of assets				50	50

Notes: ^a1 = very negative; 2 = negative; 3 = no change; 4 = positive; 5 = very positive

Adopted from Alam, Md. Mahmudul, Salwana Hassan, and Jamaliah Said. 2015. "Performance of Islamic Microcredit in Perspective of Maqasid Al-Shari'ah." *Humanomics* 31 (4): 374–84.

Akhuwat Islamic Microfinance (Pakistan)

Akhuwat was established in 2001 in Lahore, Pakistan as a not-for-profit society under the Societies Registration Act 1860 by a group of civil servants to realize a poverty-free society built on the principles of compassion and equity. Its mission is to alleviate poverty by empowering socially and economically marginalized families through interest-free microfinance and by harnessing entrepreneurial potential, capacity-building and social guidance.

Akhuwat began with providing an interest-free Shari'ah compliant micro-credit to the poor via a two-pronged strategy: (i) lowering the operational cost of providing micro-credit to the poor through institutionalized volunteerism and other means (e.g. use of places of worship for credit delivery); and (ii) mobilizing charity funds on a sustainable basis to absorb the operational costs.

Initially, Akhuwat employed a group lending method similar to the Punjab Rural support Program. While this served as a robust credit risk mitigation strategy, it also involved processes, e.g. group formation, recurring group meetings that were time-consuming.

In terms of cost management in the initial years of operation, Akhuwat provided financing based on cost recovery rather than not to charge anything and absorb all costs. The actual cost to be recovered, termed as administrative fee, was pegged at 5 percent of the loan amount, and has no link with the maturity of loan. Small loans (amount of less than \$37) were treated as entirely cost-free since they were for the

ultra-poor with the east affordability. Akhuwat also has a debt mitigation scheme in line with the Shari'ah that seeks avoidance of debt (the borrower has to restart at the initial financing of \$94 if the borrower reaches the limit of \$235).

Credit risk is mitigated using an innovative combination of credit delivery at places of worship and personal guarantees. Through an efficient monitoring mechanism, credit discipline is maintained resulting in a 99 percent debt recovery consistently over the years.

Akhuwat also operates a compulsory Shari'ah compliant insurance scheme for borrowers who are required to pay a 1 percent of loan amount as premium. In case of death or permanent disability, outstanding loan balances are waived, and needy families receive a \$42 cash payment as well as a stipend of PKR 300, equivalent to \$ 2.9 a month for 3 months.³⁹

The cumulative disbursement currently stands at \$33 million. The latest progress report of Akhuwat (2017)⁴⁰ shows that the total benefiting families are 1,907,252, while the total loans disbursed to male and female are 1,106,268 and 800,984 respectively. With the total disbursed amount of \$.40 billion, the successful recovery rate is 99.94%.

Harnessing waqf and zakat crowdfunding platform

In April 2017, it was reported that Finocracy will launch a crowdfunding platform to re-orient zakat for contemporary needs and assist contributor to track the impact of their donations. The platform, called Human Crescent, will onboard charities with positive track records that are already collecting zakat. The focus of disbursement is to six recipient categories: trafficking victims, refugees/internally displaced persons, microfinance clients, education, disaster victims, and poverty alleviation. In December 2016, World Congress of Muslim Philanthropists acquired waqf-based crowdfunding platform Narwi, which was also developed by Finocracy.

As for the target market of potential contributors, Finocracy follows a technology adoption curve where it will first focus on the Western markets since most of these markets do not have an institutionalized zakat entity, and there is a natural demand for technology to facilitate efficient collection and disbursement.⁴¹

³⁹ Mustafa, Zahid, and Nodirbek Ismailov. 2008. "Entrepreneurship and Microfinance-A Tool for Empowerment of Poor: Case of Akhuwat." School of Sustainable Development of Society and Technology. Munir, Kamal. 2012. "Akhuwat: Making Microfinance Work." Stanford Social Innovation Review. http://www.akhuwat.org.pk/eng_articles/From%20Zakat%20Beneficiary.pdf

⁴⁰ http://www.akhuwat.org.pk/progress_report.asp

⁴¹

http://www.salaamgateway.com/en/digital/story/finocracy_to_launch_new_zakat_crowdfunding_platform_in_time_for_ramadan-salaam06042017111847/

WaqfWorld is another example of Islamic endowment crowdfunding platform which was launched by the former Prime Minister of Malaysia during the 12th World Islamic Economic Foundation Forum in Jakarta in 2016. The idea of establishing waqf-based crowdfunding was first proposed by the Research Center for Islamic Economics and Finance (EKONIS), Universiti Kebangsaan Malaysia (UKM) in a roundtable discussion (RTD) organized by the Islamic Development Bank's Research and Training Institute (IRTI) in January 2016 in Jeddah. Founding patron, Tun Abdullah Ahmad Badawi saw the potential of Waqf Crowdfunding to develop the Ummah (the whole community of Muslims bound together by ties of religion). WaqfWorld.org does not charge beneficiaries or users any fees. The platform is completely free during the initial phase. Operational costs will be partially borne by voluntary contributions, and other resources provided by Ethis Ventures.⁴²

Social Impact Sukuk

There are seven stakeholder groups involved in social impact instruments: constituents, government, nonprofit service providers, investors, intermediaries, evaluation advisers, and independent assessors. At the heart of the social impact ecosystem are the constituents who directly benefit from the social services funded and scaled through a SIB. These constituents include the homeless, incarcerated individuals, youth at risk of unemployment, , early childhood education, and health services for the disadvantaged population.. To improve the well-being of the constituents by scaling preventive services, the government (federal, state or local) jointly develops a social impact bond with an intermediary. Linking all relevant stakeholders, the intermediary identifies evidence-based program solutions, raises fund to bring program to scale, project manages the program, and works closely with nonprofit service providers to ensure successful implementation of the program.

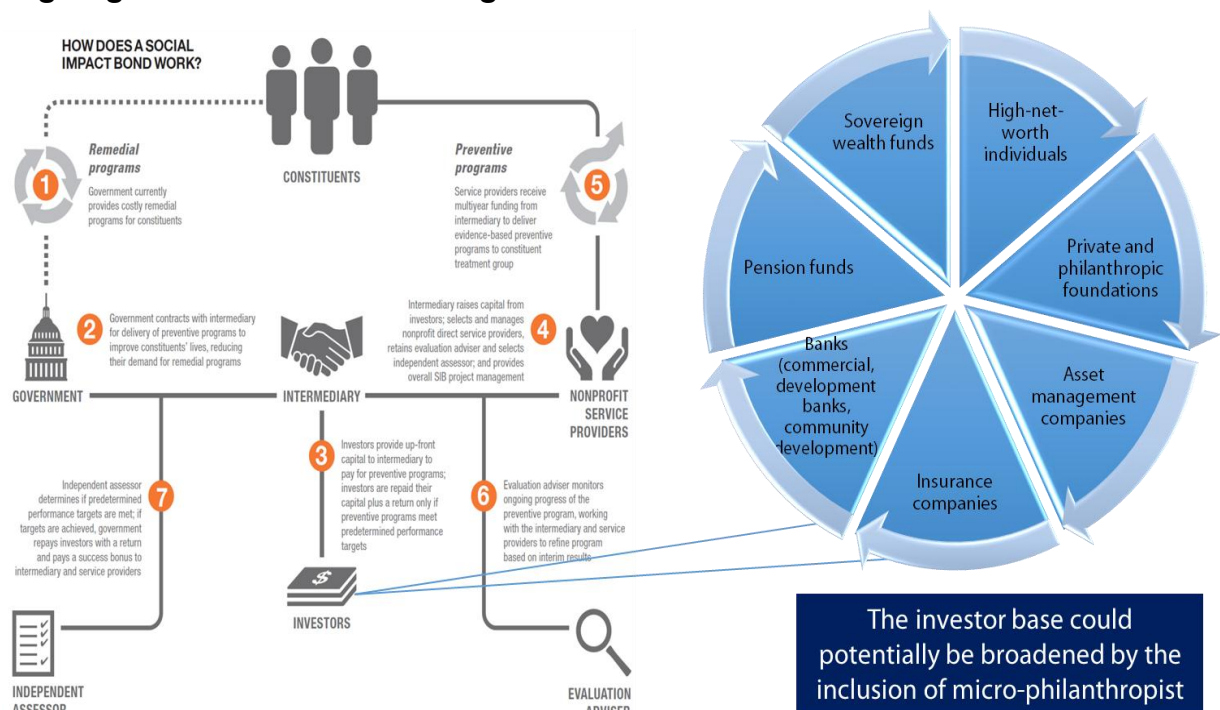
Investors can range from high-net-worth individuals, community development financial institutions to private foundations and major philanthropists who provide capital for the services of the nonprofit service provider, the intermediary, the evaluation adviser, and the independent assessor. Investors are repaid capital plus a return on investment by the government via the intermediary if the program is successful in meeting the predefined performance metrics. In the event the social program does not meet its target, investors bear the loss of capital, corresponding to the cost-saving benefits not received by the government and the society.

During the multi-year social impact contract, the intermediary monitors the performance of the program through an evaluation adviser. The evaluation adviser determines the evaluation approach, defines the performance outcomes, monitors ongoing progress, and recommends course corrections if required based on interim results. To determine whether the performance targets have been met, an independent assessor reviews and reports the performance of the constituent treatment group relative to a counterfactual.⁴³

⁴² <https://www.crowdfundinsider.com/2016/08/88684-worlds-first-islamic-endowment-crowdfunding-platform-launched/>

⁴³ Adopted with permission from Ng, Adam, Abbas Mirakhor, and Mansor H. Ibrahim. 2015. "Risk Sharing and Social Impact Partnerships." In *Social Capital and Risk Sharing: An Islamic Finance Paradigm*. New York: Palgrave Macmillan.

Figure 13: Social Impact Sukuk enhances multi-stakeholder collaboration by aligning incentives and focusing on results



Adopted from McKinsey & Company. 2012. "From Potential to Action: Bringing Social Impact Bonds to the US."

In May 2015, Khazanah National Bhd, the sovereign wealth fund of Malaysia, launched the first Ringgit-denominated sustainable and socially responsible investment sukuk to improve accessibility to quality education in Malaysia's government schools through its Trust Schools Programme. The social impact of the "Pay for Success" wakalah bi al-istithmar structure is measured based on pre-determined Key Performance Indicators (KPIs) over a 5-year timeframe. If KPIs are achieved, investors will forego a pre-agreed percentage of the nominal amount due under the sukuk as part of their social obligation. If KPIs are not met, investors will be entitled to the nominal amount due under the sukuk in full.

Figure 14: Khazanah SRI sukuk structure

PART 5: THE PROPOSED INTEGRATED ISF POOLED FUND MODEL FOR HUMANITARIAN AND DEVELOPMENT NEEDS

Part 5 aspires to formulate an integrated Islamic Social Financing model based on selected practices and models derived from Part 4.

Key guiding principles

The following are the key guiding principles that can be considered for the proposed integrated ISF pooled fund model:

1. Each of the existing models have specific target beneficiaries driven by a clear and transparent humanitarian and/or developmental objective, although the scope can be diverse like in the case of the Life and Livelihood Fund.
1. Central to the effective fund disbursement to target beneficiaries is the role of local actors or intermediaries such as local civil society as strategic implementers or partners in the projects that such funds create. The consideration for partnership should be premised on the capability, reliability and track record of such local actors in implementing the innovative social finance (in particular, Islamic) models in countries that are in need of humanitarian and developmental assistance.
2. While most models are location specific, some have a global focus. It is also noted that the institution that manages the fund does not necessarily need to be based in the locality of the beneficiaries/recipients (for example, the Salma Relief Program in UAE for beneficiaries in Palestinian, zakat and Waqf crowdfunding platforms that will focus on the Western markets).
3. Multiple sources of funding is key to maintaining the “financial sustainability” of the institution as well as “sustainable empowerment” of the beneficiaries. BMT Indonesia is a case in point whereby various types of services are offered to different levels of beneficiaries (for example, the use of takaful, skill training and other non-financial/social assistance). These models focuses on facilitating consumption and productive activities where returns or profits are to be retained for future funding (for example, the Integrated Waqf based Islamic Microfinance Model). Separation of various funding sources would also ensure Shari’ah compliance and minimize potential reputational risk.
4. The sophistication of funding instruments need to be contextualized and paced according to the context of the institution managing the fund and beneficiaries receiving those funds. For example, social impact sukuk, especially a global issuance, is a more complex structure that requires various building blocks to be put in place (for example, credit rating, pricing mechanism, regulatory approval, legal documentation and other structuring process).
5. A robust institutional and governance framework is key to the success of these models. For example, the Zakat Chamber of Sudan has an in-built organizational structure, audit, control and reporting function that would help

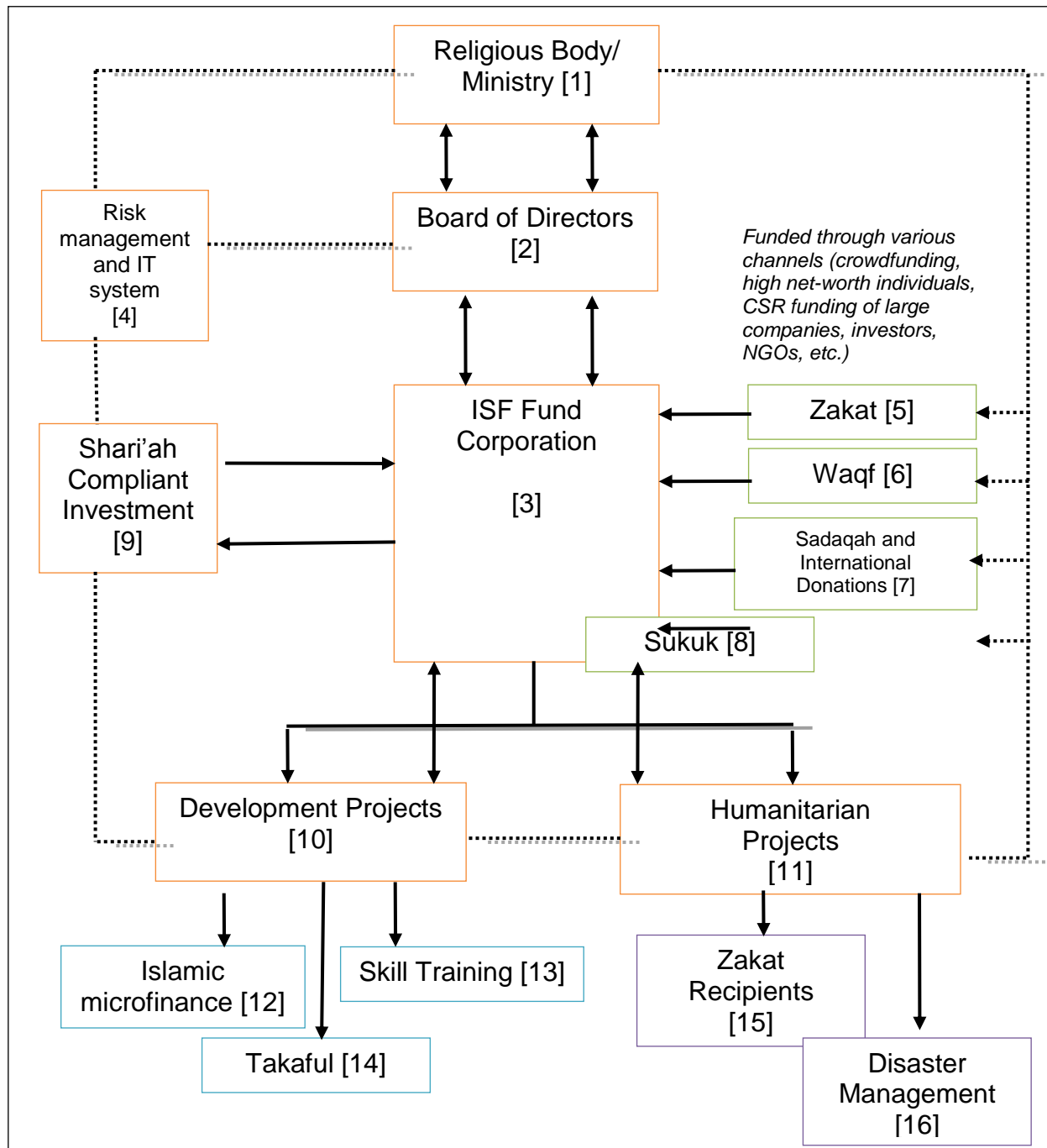
to maintain transparency and accountability. In some cases, an apex religious body or ministry to ensure compliance with the Shari'ah and with local rules and regulations would be helpful. In the case of social impact sukuk, the presence of evaluation advisers and independent assessors plays an important role in ensuring check and balance.

6. Collaboration with diverse stakeholders helps to expand outreach and impact. The cooperation of BAZNAS of Indonesia with various domestic and international institutions can be a good point of reference.
7. Assessment of impact of the funding would further enhance accountability of the process and increase confidence of donors/investors. The assessment of AIM microfinance program against the principles of Maqasid al Shari'ah is a basic illustration. Other socio-economic impact assessment tools can be adopted in the future, possibly on a real-time basis given the technological improvements nowadays.

Illustration and operational steps of the proposed model

The following Figure illustrates the proposed model and its operational steps.

Figure 15: Proposed Integrated ISF Pooled Fund Model for Development and Humanitarian Projects



Note: The double arrow shows management flow, the dotted line denotes information flow and the solid line indicates financial flow.

[1] is the religious body or Ministry as the highest decision making body in the institution. It is also responsible for appointing the board of directors.⁴⁶ In the absence of such body, an entity that wins public trust and support can act as an apex body. It could be a private company, board of trustees or from civil society within the locality where the model is adopted. Flexibility is needed as the diverse contexts and requirements of different jurisdictions.

[2] are the Board of Directors, usually appointed by the apex body. The role of the Board members is to oversee its strategic direction, financial operation and maintain its legal, Shari'ah and ethical standing. The membership can include outstanding Shari'ah scholars, humanitarian experts, Islamic social finance experts, investor representatives, and NGOs.

[3] is the ISF Fund Corporation, the entity that is responsible for sourcing, managing and distributing the fund. It is responsible and reports to the Board of Directors. Further feasibility study is required to determine the appropriate legal and regulatory structure for the ISF Fund Corporation.

[4] is the risk management and IT system, which integrates the functions of main entities: the apex body, board of directors, ISF Fund Corporation, Shari'ah compliant investment vehicle, sources of funds, development and humanitarian projects. The IT system is established for efficient flow of information, especially when large number of contributors and humanitarian/developmental projects are involved. The ability to match contributors and beneficiaries on a real time basis and to monitor the impact of the contribution would require a robust technological infrastructure. In some cases, big data machine learning has been used. This ensures good governance in terms of disclosure, transparency and accountability.

[5-8] are the sources of funds that the Corporation will solicit. The Zakat and Waqf funds [5 and 6] are typically contributed by Muslims with certain level of income and wealth. Fund [7] is donation from international philanthropists who could be individuals, institutions and states, Muslims and non-Muslims. The ISF Corporation can be designed to receive funding from non-Islamic sources or to have it solely for ISF funding. However, if the funding is from non-Islamic sources, the ISF Corporation has to utilize the funding in manner agreed with the donors as long as it does not negatively impact the ability of the ISF Corporation to be a Shari'ah compliant institution. Alternatively, international donors (non-Islamic sources) can cover the operational cost of the Corporation.

Fund source [8] is Sukuk. The Corporation, through a special purpose vehicle, can issue Sukuk to solicit for investments in a particular project. Its structure is usually determined by the nature of the contract, equity, lease, etc. and by the type of the project.⁴⁷

⁴⁶ This is the case with Selangor Waqf Corporation, BAZNAS and the Sudanese Zakat Chamber.

⁴⁷ The Islamic Religious Council of Singapore (MUIS) issued a \$35 million Sukuk Musharakah to finance the development of its Waqf assets (www.muis.gov.sg/wakaf).

The funds received by the corporation will be invested in Shari'ah compliant investment [9]. Some of the proceeds from these investments are channeled to the development system department [10] to empower the poor, needy and microenterprises. The department will allocate these proceeds for three purposes: to finance individuals with micro-enterprises through Islamic microfinance [12].⁴⁸ The second part of the allocation will be allocated for skill training of the beneficiaries [13]. Improving their skills is another tool of mitigating credit and market risks. The third allocation is earmarked for Takaful or Islamic Insurance coverage [14]. The poor are exposed to many risks from health, financial to natural disaster risks. Some of the investment proceeds will be allocated to the humanitarian projects [11]. These proceeds will be spent on individuals affected by natural disasters [16]. The department will allocate the Zakat fund [5] for the eight types of zakat recipients [15] as required by the Shari'ah.

⁴⁸ Such financing can be sale based [Murabahah], leased based [Ijarah], fee based [Wakalah] or even equity based [Musharakah or Mudarabah].

PART 6: CONCLUSION AND RECOMMENDATIONS

The novelty of this study lies in developing an integrated Islamic Social Financing pooled fund model. This noble idea follows the efforts at the World Humanitarian Summit in 2016 and the creation of NEAR network in developing innovative funding models at the national levels to meet humanitarian and development needs. The proposed theoretical framework of the model is simple, practical and robust.

This research project reviewed the existing literature and leading practices in order to formulate an integrated ISF model. Most theoretical models on ISF are in the areas of investments, agriculture, education and SMEs. Focus of the research has been on the governance, management and provision of efficient financial services in various model and institutions

The findings suggest that most of these models and institutions have good governance structure, sound management, robust IT system and effective internal and external control. They have also put in place mechanisms to mitigate risks and to ensure disclosure and transparency. Yet, none of them have the experience of creating a pooled fund.

The proposed model has seven main structures: 1) the apex body; 2) the board of directors; 3) the entity operating the fund (ISF Fund Cooperation); 4) the risk management and IT system; 5) the source of funds; 6) the Shari'ah compliant investment vehicle; and 7) two departments that allocate the investment proceeds and zakat collection to developmental and humanitarian projects.

The funds are disbursed in a way that achieves two main objectives. The first objective is to empower the clients through three investment modes: Islamic microfinance, human resource development and Takaful. The second objective is to respond directly to urgent humanitarian needs of those affected (zakat recipients and disaster victims).

The model also diversifies sources of funds to include donations from international donors as well as the potential use of social impact sukuk to invite participation from investors. For the purpose of Shariah compliance and financial sustainability, most of the funds collected will be invested in Shari'ah compliant vehicles. Such form of investment will gain the trust and confidence of Muslim donors and investors that their funding is being managed and used in line with the tenets of their religion.

Central to the effective fund disbursement to target beneficiaries is the role of local actors or intermediaries such as local civil society as strategic implementers or partners in the projects that such funds create. The consideration for partnership should be premised on the capability, reliability and track record of such local actors in implementing the innovative social finance (in particular, Islamic) models in countries that are in need of humanitarian and developmental assistance.

Moving forward, the following next steps shall be considered:

1. Identify a pilot country for the integrated ISF model to be implemented.

2. Validate the proposed integrated ISF model and its variants in the pilot country through stakeholder consultation (regulators, NGOs, beneficiaries, legal and Shariah advisors, investor, developmental institutions and other key advisors).
3. Identify the local actors or intermediaries for effective fund disbursement to target beneficiaries.
4. Map the strategic priorities, needs and selection process for the fund (contributors and recipients).
5. Conduct financial analysis, risk assessment, technical analysis, regulatory analysis.
6. Identify funding sources and apply for funding for operationalization of the integrated ISF model.
7. Identify human resources and the necessary information technology for the operationalization of the model.
8. Identify the appropriate Islamic social financial contracts and structure through consultation with Shari'ah scholars.
9. Conduct assessment of the impact of the model over time.

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APPENDIX

Appendix 1: Overview of giving and its concept in Islam

Charity is as old as the history of man on earth. The Quran in Surah al-Ma'idah - (5:27-31) relates the story of the two sons of the first man on earth – Adam (Peace be upon him). Allah commanded the two sons to give the charity part of their wealth as a sign of intimacy (al-Taqrub) to the Almighty. One of the sons, the righteous, gave the best of what he owned from his wealth and Allah accepted it. The other son hesitantly gave away from the lowest quality of his possessions and it was rejected by Allah. From the time Prophet Adam (Peace be upon him) hitherto, charity has been part of human civilization but varied with time and place. Some charitable activities were prescribed in divine scriptures and others evolved with people's customs and experiences.

In the Western literature, there are several theories and models on charity giving. The literature provides several contextual meanings of charitable giving. It has broader and long-term connotation of social investing, to build human and social capital through its investment in education which will enhance social and economic opportunities for those who are less privileged, and in building strong organizations to address social ills. Charitable giving can be seen as a wide-spread and frequently recurring form of pro-social behavior that encourage a positive impact on society and on the people living in it. Through charitable giving, donors can contribute to equitable wealth distribution thereby supporting a cause that has effect to changes of the world in one's desired direction.⁴⁹

Charity or Sadaqah (plural, Sadaqat) in Islam is multi-dimensional, relating to all the spheres of human life: religious, legal, spiritual, moral, social, economic and political. It is religious in the sense that giving in charity is considered an act of worship. Individuals are encouraged to constantly give in charity hoping for rewards from Allah. The more an individual is sincerely involved in helping fellow mankind in charity, the closer he or she becomes to Allah and the higher is the chance of attaining success in the hereafter. Legally, Islam classifies charity into two main categories: compulsory and voluntary. The former includes Zakat, and zakat al-Fitr, which is normally given towards the end of the fasting month to help the poor to rejoice the Eid celebration with their fellow wealthier Muslims. The voluntary charity includes all kinds of Shari'ah compliant material wealth as well as non-material. The material wealth includes Waqf [endowment or foundation], Hibah [gifts in all forms], donations, grants, transfers and monetary assistance. Meanwhile the non-material category includes all forms of good deeds such as good words, smile, services to family members, the elders, children, animals and the environment. Islam also requires that the source of the income and where it is spent in charity must be Shari'ah compliant, free from any negative element of injustice (al-Quran, 4:29) such as Riba (including interest), Gharar (unnecessary risk) and Maysir (speculation and gambling).

⁴⁹ Bekkers, René, and Pamala Wiepking. 2011. "A Literature Review of Empirical Studies of Philanthropy: Eight Mechanisms That Drive Charitable Giving." *Nonprofit and Voluntary Sector Quarterly* 40 (5): 924–973.

Spiritually, the act of giving cleanse the soul from the “diseases of the heart”, mainly arrogance, showing off, envy, greed, among others according to Imam Al-Ghazali. These diseases are the main hindrances for people to sacrifice their wealth for others. Rather, charity will instead instill positive values such as kindness, compassion and empathy towards fellow human beings and all the creations within his or her surroundings. Before Zakat was made compulsory in the second year of al-Hijrah, most of the Quranic verses on charity were meant to strengthen the Muslim spiritually in terms of cleansing their souls of unlimited wants for accumulating wealth, and instilling in them positive spiritual values and strength. These verses were also meant to instill in them their moral obligations towards the less privileged members of the society that include the poor, the destitute, the orphans and the widows.

Morally, Islam expects individuals to display love, respect, humanity and care for one another through charity. It is a moral duty to ensure peaceful co-existence. The social dimension of charity is more pronounced in Zakat. The donors and the eight categories of the recipients cut across the larger sections of the society, notably, the poor, the needy, those in financial stress, those travelers in protracted displacements such as refugees, etc. Economically, charity transfers resources from the rich to the poor. The more the rich sacrifice from their wealth to the poor, the narrower will be the income and wealth disparity between the two groups. Politically, Islam allows the state institutions to regulate the collection and distribution of charity, especially the compulsory one. The state is also allowed to use charity for maximizing the welfare of the society, especially those in dire need.

Appendix 2: Malaysia Sustainable and Responsible Investment (SRI) Sukuk Framework

The framework for Sustainable and Responsible Investment (SRI) developed by the Securities Commission Malaysia in 2014 was a positive response to the rising trend of social impact bonds and green bonds issued globally to finance sustainable activities.

Malaysia Sustainable and Responsible Investment (SRI) Sukuk Framework launched on 28 August 2014

Objective: Facilitate financing of sustainable and responsible investment initiatives

- Meet demand of retail and sophisticated investors for access to a wider range of investment products and facilitate greater participation in the sukuk market
- Growing concerns over environmental and social impact of business and greater demand for stronger governance and ethics from businesses
- Facilitate the creation of an eco-system conducive for SRI investors and issuers
- An extension of the existing sukuk framework; therefore all other requirements in the Guidelines on Sukuk continue to apply

Additional areas addressed in SRI sukuk framework:

- Utilisation of proceeds
- Eligible SRI projects
- Disclosure requirement
- Appointment of independent expert
- Reporting requirement

Source: Securities Commission Malaysia

Projects that can be deemed an 'Eligible SRI Project'

Natural Resources	Renewable Energy / Energy Efficiency	Community and Economic Development	Waste Property / Assets
Sustainable land use	New or existing renewable energy (solar, wind, hydro, biomass, geothermal and tidal)	Public hospital / medical services	Development of wast properties / assets
Sustainable forestry or agriculture	Efficient power generation and transmission systems	Public educational services	
Biodiversity conservation	Energy efficiency which results in reduction of greenhouse gas emissions or energy consumption per unit output	Community services	
Remediation and redevelopment of polluted or contaminated sites		Urban revitalisation	
Water infrastructure, treatment and recycling		Sustainable building projects	
Sustainable waste management		Affordable housing	

Appendix 3: Summary terms of Khazanah SRI Sukuk and IFFIm's Vaccine Sukuk

Khazanah SRI sukuk

What is Khazanah SRI sukuk?

- Khazanah Nasional Berhad (Khazanah) is the strategic investment fund of the Government of Malaysia. It is entrusted to hold and manage the commercial assets of the Government, and to undertake strategic investments on behalf of the nation.
- Khazanah (from 2010 to 2014) has been funding Yayasan AMIR's (YA) Trust Schools Programme through its corporate social responsibility (CSR) allocation. YA is a not-for-profit foundation incorporated by Khazanah to improve the accessibility of quality education in Malaysian Government schools through a Public-Private Partnership with the Ministry of Education.
- Khazanah, via Ihsan Sukuk Berhad established a Ringgit-denominated Sustainable and Responsible Investment (SRI) Sukuk Programme of RM1.0 billion to fund eligible Shariah-compliant SRI projects, which include amongst others improving the quality of life for the society via funding the Trust Schools Programme under YA.
- This is the first programme approved under Malaysia's Securities Commission's SRI Framework introduced in August 2014.
- On 18 June 2015, Khazanah successfully issued Malaysia's first SRI Sukuk, a RM100 million sale with a periodic distribution rate of 4.30% per annum. The sukuk was successfully priced after a day of book building; meeting Khazanah's size and pricing expectations.
- The proceeds will be utilised to fund a minimum of 20 Trust Schools under YA's Trust Schools Programme for 2015.

Summary terms

Issuer:	Ihsan Sukuk Berhad ("Ihsan"), a special purpose vehicle initiated by Khazanah
Obligor:	Khazanah Nasional Berhad ("Khazanah")
Principal adviser/lead arranger:	CIMB Investment Bank Berhad ("CIMB")
Joint Shari'ah advisers:	CIMB Islamic Bank Berhad and Amanie Advisors Sdn Bhd
Facility:	RM1.0 billion in nominal value Sukuk programme established under the "Sustainable and Responsible Investment Sukuk" framework ("Sukuk Programme")
Facility tenure:	Twenty five (25) years from the date of the first issuance
Offering tenure:	Seven years
Issue price	100%
Periodic distribution payment frequency	Annual basis
Rating	Initial rating of AAA(s) by RAM Rating Services Berhad

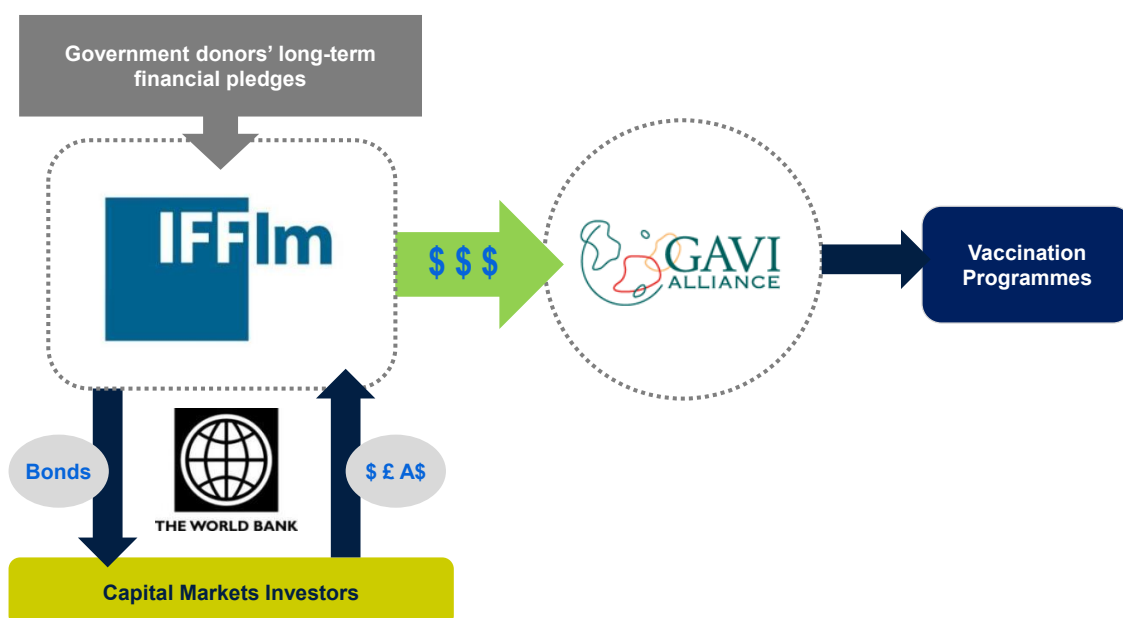
Islamic principle	Wakalah Bi Al-Istithmar
Use of proceeds	Ihsan: To purchase the Sukuk Investments Khazanah: To fund Yayasan AMIR's Trust Schools Programme for 2015
Governing law	Laws of Malaysia
Key performance indicators (KPI)	(i) A minimum of twenty (20) schools are selected under Yayasan AMIR's Trust Schools Programme for a five (5)-year intervention period (the "5-Year Intervention Period") during the term of the First Sukuk Ihsan ("Identified Schools"); (ii) At least fifty per cent. (50%) of the teachers of the Identified Schools are rated at the Establishing level or above in their observations after the end of their respective Identified Schools' 5-Year Intervention Period; and (iii) At least fifty per cent. (50%) of the senior leadership of the Identified Schools are rated at the Establishing level or above in their observations after the end of their respective Identified Schools' 5-Year Intervention Period.

Source: Khazanah Nasional (2015). "Sustainable & Responsible Investment Sukuk".

IFFIm's Vaccine Sukuk for the International Finance Facility for Immunisation ("IFFIm") in December 2014

What is the IFFIm?

- International organization established in 2006 to frontload funding for immunization in the poorest countries of the world
- Supported by nine sovereign governments
- No staff of its own - World Bank acts as IFFIm's Treasury Manager
- Provides funds for immunization through GAVI, the Vaccine Alliance
- Governments have entered into long-term legally binding grant agreements with IFFIm, which has been constructed to accommodate additional donors.

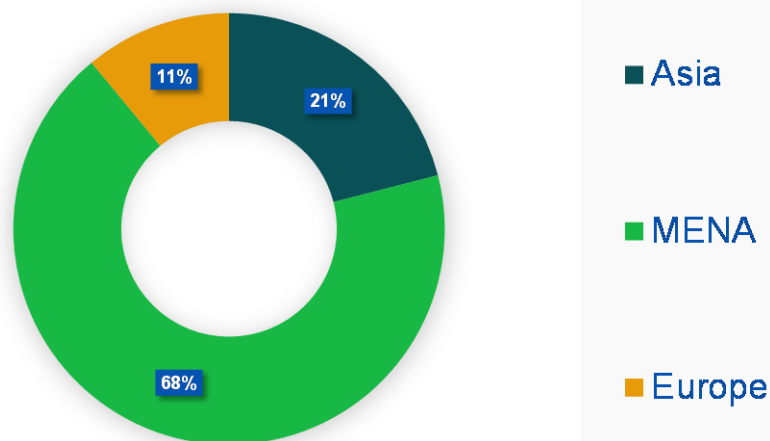


Donors	Ratings (as of 28 March 2014)	Grant (US\$ equivalent)	
United Kingdom	AA+/Aa1/AAA	US\$ 2,980 million	} Approximately US\$6.3 billion
France	AA+/Aa1/AA	US\$ 1,719 million	
Italy	BBB+/Baa2/BBB	US\$ 635 million	
Norway	AAA/Aaa/AAA	US\$ 264 million	
Australia	AAA/Aaa/AAA	US\$ 256 million	
Spain	BBB+/Baa2/BBB	US\$ 240 million	
The Netherlands	AAA/Aaa/AA+	US\$ 114 million	
Sweden	AAA/Aaa/AAA	US\$ 38 million	
South Africa	BBB/Baa1/BBB-	US\$ 20 million	
Brazil	(BBB/Baa2/BBB-) has also been considering a grant to IFFIm of US\$ 20 million		

Summary Terms

Issuer:	IFFIm Sukuk Company Limited
Obligor:	IFFIm
Issue Type:	Senior, Unsecured Trust Certificates
Issue Rating:	Aa1 (Moody's)
Issue Date:	December 4, 2014
Maturity Date:	December 4, 2017
Profit Rate:	USD 3 month LIBOR + 15 bps (quarterly)
Governing Law:	English
Joint Leads:	Standard Chartered (Global Coordinator), Barwa Bank, CIMB, NBAD, NCB Capital
Co-Managers:	BIBD, Union Bank
Amount:	US\$500 million
Structure:	Floating rate based on commodity murabaha

Geographical Distribution



Source: Bennett, Michael. 2015. "The World Bank, Islamic Finance and Sustainable Investing." 6th SC-OCIS Roundtable, Oxford, March 2015.